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IN THE
United States Court of Appeals
For the Ninth Circuit

see vol. 2511

DAWSON COUNTY, MONTANA,

Appellant,

vs.

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS, on their own behalf and on behalf of all bondholders of the Upper Glendive-Fallon Irrigation District of the State of Montana, and UNITED STATES OF AMERICA,

Appellees,

and

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS, on their own behalf and on behalf of all bondholders of the Upper Glendive-Fallon Irrigation District of the State of Montana,

Appellants,

vs.

EDNA YALE, ALLEN W. YALE and RUBY YALE (his wife), and RUTH PETTERSON and HANS PETTERSON (her husband), THE SCOTTISH AMERICAN MORTGAGE COMPANY, LIMITED, UNITED STATES OF AMERICA, DAWSON COUNTY and PRAIRIE COUNTY,

Appellees.

Upon Appeals from the District Court of the United States
for the District of Montana.

BRIEF FOR APPELLANTS.

(Second Appeal)

FILED

FEB 28 1949

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UNITED STATES OF AMERICA, DAWSON COUNTY
and PRAIRIE COUNTY,

Appellees.

**Upon Appeals from the District Court of the United States
for the District of Montana.**

BRIEF FOR APPELLANTS.

(Second Appeal)

OPINION BELOW.

This appeal is from the judgment entered by the District Court on November 24, 1948, pursuant to findings of fact made and conclusions of law stated by direction of this Court in its *per curiam* opinion filed November 1, 1948.

Judgment was in favor of the bondholders as to distribution of the funds in the registry of the Court being an award of just compensation in a condemnation action.

JURISDICTION.

Jurisdiction of the District Court rests in the general condemnation act of August 1, 1888, 25 *Stat.* 357, 40 *U. S. Code*, Section 257, and the act of October 14, 1940, 54 *Stat.* 1119, and Sections 1331 and 1345, Title 28, *U. S. Code*.

The jurisdiction of this Court rests on Section 1291, Title 28, *U. S. Code*.

QUESTION PRESENTED.

These appeals are taken by adverse claimants to the funds deposited in the registry of the Court in a condemnation proceeding wherein a declaration of taking was filed on April 27, 1942, the amount deposited as just compensation is not being contested in this action.

Notice of appeal by Dawson County, Montana, and Prairie County, Montana, were filed December 10,

1948. Cross appeals by bondholders were filed on December 27, 1948.

The question before the Court was whether the bondholders had a lien upon the lands at the time of the filing of the declaration of taking on April 27, 1942. Title to said lands having passed to the counties by tax deeds taken in 1931 and 1939.

The disposition of the compensation deposited in the registry of the Court was the sole question for decision herein involving questions of law only.

Partial distribution to the counties was made on July 11, 1944, of the amount of the general taxes against said lands at the time of taking the tax deeds. The matter of the further distribution of the remaining funds was reserved by the Court. (Transcript pages 67 and 68.)

The special assessments made against the lands involved were challenged by the counties. (Appellants' Brief page 12.)

STATEMENT OF THE CASE.

We supplement the statement of the case, pages 1 to 4 inclusive in appellants' brief on file herein, with the following:

Under Montana law, a tax deed creates a doubtful title and the present action was brought by the United States to quiet title. (Transcript page 104.) The value of the lands to be condemned was agreed upon by the appellant counties and the United States. No appearance challenging the action was made by the appel-

lants as they appeared only for the purpose of distribution of the compensation agreed upon deposited in the registry of the Court when the action was commenced. (Transcript pages 98, 99, 101, 104 and 105.)

The counties and the United States agreed upon condemnation as the best procedure to quiet title to obtain immediate possession in the United States by reason of the provisions of Section 258-A Title 40, *United States Code Annotated* under which the fee title to the lands vests in the United States upon the filing of the declaration of taking and the deposit of the funds determined to be just compensation.

Under Montana law any decree to quiet title to the lands brought in the State Courts where service of summons by publication process is necessary by reason of the non-residence of the defendants, would not become final until one year after the entry of the decree of such Court under the provisions of Section 9187 *Revised Codes of Montana 1935*, and the decisions of the Supreme Court of Montana construing said section. The complaint shows the United States required the immediate possession of the lands. (Transcript pages 25 and 26, Paragraph VIII.)

SPECIFICATION OF ERRORS.

Appellant intends to rely on this appeal on the contentions that the District Court of the United States for the District of Montana, being the trial Court below, erred:

1. In adopting as its rule in making distribution of the funds in the registry of the Court the *dictum* of the Montana Supreme Court in a decision wherein the method of distribution of funds derived from the sale of tax deed lands was not before said Court for decision.

2. In finding overpayments to appellants of taxes due them where the contract between the United States and appellants fixed the acreage to be sold to the United States by appellants and the purchase price was agreed upon in a lump sum with no division into tracts.

3. In the judgment entered distribution is made to appellees who have no lien on the tax deed lands and no right to the funds, said order being in fact a collateral attack on the tax titles of appellants not permissible under Montana law.

4. In its interpretation of Chapter 63, Laws of Montana, 1937 which has no application to this cause as no taxes were levied after the tax deeds were taken by appellants and such act has been determined by the Supreme Court of Montana to be prospective and not retroactive.

5. In failing to give proper consideration to the stipulation between the United States and these appellants which fixed by agreement the lands to be taken and the price to be paid by the United States, which becomes binding upon both parties in a condemnation action.

6. In ordering judgment against the United States with interest from July 11, 1944 in favor of the appellee bondholders the records showing the value of the lands taken by the United States was fixed by agreement with the owners, the appellants herein such judgment and interest thereon being void.

7. The judgment entered herein is contrary to the admissions of the parties by their pleadings in that Paragraph III of defendant, Dawson County's answer was not denied by reply and therefore the facts therein set forth cannot now be challenged by the appellees. (Transcript pages 49-50.)

8. The award to the appellee bondholders by the judgment herein is contrary to the decisions of the Supreme Court of Montana wherein they are classified the same as any mortgagee investor with no greater rights and the same obligations as to payment of taxes to protect the lien of their investment.

9. Conclusion of law #1 adopted by the Court is contrary to the statute law of Montana, and the decisions of its Supreme Court thereon and creates a precedent unwarranted under such statutes and decisions in distributing the remainder of the compensation deposited in the Court to bondholders who had no lien on the fund having lost all claim of lien to the lands taken by the tax deeds. Such conclusions should not be adopted by this Court as it would in effect require all counties in Montana to divide the sale price of tax deed lands to all persons who held liens on the lands sold prior to the tax deed proceedings.

SUMMARY OF ARGUMENT.

(a) The distribution ordered in the judgment entered awarding the remaining funds in the registry of the Court to the bondholders was based upon *dicta* in a decision of the Supreme Court of Montana in a case where the Court suggested a method of disposition of the funds derived from the sale of the tax deed lands by the county. The Court itself stated the matter was not then before it for decision, and the case is not authority for the conclusions adopted by the trial Court in its judgment.

(b) The judgment entered awarding the funds to the bondholders representing just compensation is a collateral attack on the tax title to these lands owned by the counties and sold to the United States. Such an attack is contrary to the decisions of the Supreme Court of Montana relating to tax deed titles.

(c) The United States and the counties stipulated on the value of the tax deed lands purchased by agreement between them in which the acreage was fixed and no division of such acreage was made by the parties into tracts. Such agreement and stipulation is binding upon both parties.

(d) The bondholders invested in lands subject to general taxation and in order to protect such investment were by law obligated to see that the general taxes levied in each year were paid or the lands redeemed from the tax sale or the bondholders could purchase the outstanding tax sale certificate and take tax title to the lands.

(c) Under Montana law the tax title of the counties was an independent grant from the sovereign and the lands were free from all prior liens and encumbrances including prior tax liens.

(f) No irrigation assessments were made after the tax deeds were taken so that Chapter 63 of the Laws of Montana, 1937, has no application in this action. The act being prospective and not retroactive.

(g) The equity rule followed by the Court below does not apply in this case as the award of just compensation is payable only to the owner of the land. The same being free and clear of all encumbrances and liens by the taking of the tax deeds, under Montana law and decisions.

(h) The judgment entered herein sets a precedent on a point of fundamental law not passed upon by the Supreme Court in its decisions or enacted by Montana Statute Law. The award to bondholders of part of the sale price of the lands taken by the United States of America where they had no lien on the lands under Montana law, if followed by this Court, would require the distribution of a part of the sale price of tax deed lands sold by the counties to be paid to all holders of liens of record prior to the tax deeds which is contrary to express holdings of the Supreme Court of Montana.

(i) Appellant, Dawson County, Montana in Paragraph 3 of its answer set forth its claim and title to the purchase price of the land sold by it to the United States. Further pleading no person whom-

soever had any right, thereto, and its title was free from all liens or encumbrances and claimed the right to the distribution of the just compensation for said lands. None of these allegations were denied by reply and they now stand admitted in this proceeding and entitle said appellant to the funds remaining in the Registry of the Court applicable to said lands of said County taken by the United States.

ARGUMENT.

We shall follow our specification of errors in the order of presenting our argument in this cause.

We first call attention to the case (Transcript page 152) relied upon by the bondholders and adopted by the Court in its findings. *State v. Board of Commissioners of Cascade County*, 89 Montana 37, (1931) 296 Pacific 1. At the outset we call attention to the statement of our Supreme Court on points 17 and 19 thereof as follows:

“The decision of a court in any case should be read in the light of the precise question then under consideration. *Cohens v. Virginia*, 6 Wheat. 264, 5 L. Ed. 257. This court, speaking through Mr. Chief Justice Callaway, in the case of *State ex rel. Walker v. Jones*, 80 Mont. 574, 261 P. 356, 360, 60 A. L. R. 551, said: ‘It is the rule of universal application that general expressions used in a court’s opinion are to be taken in connection with the case under consideration’—citing *Bramwell v. United States F. & G. Co.*, 269 U. S. 483, 46 S. Ct. 176, 70 L. Ed. 368. And again, in

the case of *Sun River Stock & Land Co. v. Montana Trust & Savings Bank*, 81 Mont. 222, 262 P. 1039, 1047, this court said: 'In considering the meaning and intent of the language of an opinion one must have constantly in mind the facts of the case in which the opinion is written. For, as Chief Justice Marshall observed, it is impossible so to use language as that general expressions apply in every instance with the same meaning to every condition of facts'—citing *Chater v. San Francisco Sugar Refining Co.*, 19 Cal. 220."

This case was followed in *Edquest v. Tripp and Dragstedt, et al.*, 93 Montana 446 (1933).

In the case above quoted the Montana Supreme Court had before it for decision this question only whether or not the lien of irrigation district bonds is a general obligation of the irrigation district or merely a charge against the lands within the district and the holding in that case reversed the former decisions of the Supreme Court in the case of *Cosman v. Chestnut Valley Irrigation District*, 74 Montana 111, 239 Pacific 879, 40 A. L. R. 1344 (1925).

After determining the matter at issue, the Court went on to say at page 95, Volume 89, *Montana Reports*:

"It has been suggested by counsel for respondents that the county hold title to these lands as a trustee. While this matter is not directly before the court for determination, yet we observe in connection therewith that, when the county acquires these lands by tax deed on account of de-

linquent taxes and irrigation district assessments, it takes and holds such title as a trustee. The moneys derived from the sale of such lands are trust funds. The parties and entities interested in that fund are the school districts within the county, the county itself, the state to the extent of the taxes owing to it, the bondholders, and the holders of the debenture certificates.”

The statement of the Court above set forth shows clearly what can happen in a case where the Court endeavors to express its views on matters not before it for decision. In connection with this statement above referred to this Court in the case of *Judith Basin Irrigation District v. Malott*, 73 Fed. 2nd 142, (1934) 97 A. L. R. 508, made the following pertinent statement:

“The Supreme Court of Montana in *State ex rel. Malott v. Board of County Commissioners*, 89 Montana 37, 296 Pacific 1, expressly overruled its previous decisions and decided irrigation district bonds were not the general obligation of the district, but merely a charge against the lands within the district, and that each tract of land was only liable for its proportion of the entire bonded indebtedness. It was also held in that case that when the land had been sold for taxes and when conveyed to the county by tax deed and subsequently sold by the county, as provided by law, that the purchaser acquired the lands free and clear from any lien of the bonds or any future taxation for the payment thereof.”

Citing Section 7232 of the *Rev. Codes of Montana*, as to the duty to assess the tax annually for the pay-

ment of the bonds and at page 514, in 97 A. L. R. point #8, "we also suggested that the question of the disposition of the funds derived by the sale of the lands deeded to the county for the State, county and irrigation district taxes suggested by the Supreme Court of Montana in its dictum in the case of *State ex rel. Malott v. Board of County Commissioners*, supra, was in conflict with the statutory rule *Revised Code of Montana, 1921, Section 2235 Subdivision 1*, as amended by laws of 1927, Chapter 85, Section 3, in relation thereto.

In the case above quoted, the same question was before this Court, as was before the Supreme Court of Montana in the case known as the *Malott* case, 296 Pacific 1, 89 Montana 37. Subsequent to this decision, which was never appealed to the Supreme Court of the United States for final decision, the United States Supreme Court in the case of *Erie Railroad Company v. Tompkins*, 114 A. L. R. 1457 (1938), held contrary to this Court's decision in the *Judith Basin v. Malott* case above referred to, the holding being:

"The phrase, 'laws of the several states,' as used in statute requiring federal courts to apply laws of the several states except in matters governed by federal Constitution or statutes *held* to include not only state statutory law, but also state decisions on questions of general law, in absence of any constitutional provision purporting to confer upon federal courts power of declaring substantive rules of common law applicable in a state."

This doctrine is followed in the Montana case of *Toole County Irrigation District v. Moody*, 125 Fed-

eral 2nd 498 (1942) from which we quote the following specific holdings made by the Court, none of which support the findings of the district Court in its conclusion of law #1 wherein this decision is quoted as supporting such conclusions. The holdings of the Court in said case, are as follows:

1. "Recovery could not be had against district in action on irrigation district bonds on ground that bonds even if not accrual obligations of district when issued had become so by reason of a subsequent agreement, where action was not based upon the agreement and agreement in so far as it purported to make the bonds general obligations of district was void."

2. "The doctrine that a Federal Court must follow decisions of the highest Court of a state is as applicable to actions founded on contract as to tort actions."

3. "The Federal Courts in determining whether bonds issued by Montana irrigation district were general obligations of the district were required to follow decisions that such bonds issued pursuant to Montana statutes were not general obligations of irrigation district, but merely a charge against land within the district." *Revised Codes of Montana 1921*, Sections 7208, 7210, 7213, 7226, 7229, 7231 and 7232.

4. Judicial Decisions.

"The act of Circuit Court of Appeals in action on Montana Irrigation District bonds in giving effect to Montana decisions that bonds did not constitute general obligations of irrigation district, did not constitute 'an impairment of obligation of contract' since the Courts' decision

was merely that the obligation allegedly impaired did not exist." Revised Codes of Montana, Section 7210.

This Court should not adopt the doctrine of the Supreme Court in the *Malott* case herein before cited, as to such doctrine the Montana Courts have held:

1. In the case of the *Empire Theatre Company v. Cloke et al.*, 53 Montana 183, 163 Pacific 107. (1917.) "An *obiter dictum* is a gratuitous opinion, an individual impertinence which, whether it be wise or foolish, right or wrong, bindeth none—not even the lips that utter it."

2. *Mettler v. Ames Realty Co.*, 61, Montana 152, 201 Pacific 702. (1921.) "Observations made during the course of an opinion upon a subject not involved in the case do not require explanation and are not binding upon the Court." At page 165 the Court says, "The language of Honorable Simeon E. Baldwin is particularly pertinent here: 'If the writer of a judicial opinion has permitted his pen to move too fast and gone beyond the exigencies of the case, it is the strength of our system of remedial justice that his words lose their authority, as soon as the bounds of necessity are passed.' " (Citing 18 Yale Law Journal pages 1-8 inclusive.)

3. "All that is necessary to make a decision of this Court authoritative is that there shall appear to have been an application of the judicial mind to the precise question adjudged and that the point was fully considered." *Spratt v. Helena Power Transmission Company*, 37 Montana 60, 94 Pacific 631. (1908.)

4. We quote from 14 Am. Jur. 295, Section 83, "The doctrine of *stare decisis* contemplates only such points as are actually involved and determined in a case, and not what is said by the Court or judge outside the record or on points not necessarily concerned therein. Such expressions being obiter dicta do not become precedents." Citing *State ex rel. Walkel v. Jones*, 80 Montana 574, 261 Pacific 356, 60 A. L. R. 551. (1927.)

5. In the case of *Hawks v. Hamill* (1933), 288 U.S. 52, 77 L. Ed 610, 53 Supreme Court 240, Justice Cardozo observed: "An opinion may be so framed that there is doubt whether the part it invoked as an authority is to be ranked as a definitive holding or merely a considered dictum. But the result will not be changed though the definition of perpetuities be something less than a decision. At least it is a considered dictum, and not comment merely obiter. It has capacity, though it be less than a decision, to tilt the balanced mind toward submission and agreement.

In controversies so purely local, little gain is to be derived from drawing nice distinctions between dicta and decisions. Disagreement with either, even though permissible is at best a last resort, to be embraced with caution and reluctance. The stranger from afar, unacquainted with the local ways, permits himself to be guided by the best evidence available, the directions or the counsel of those who dwell upon the spot." See also quoting with approval *Blue Valley Creamery Co. v. Consolidated Products Co.*, 1936, CCA 8th 81 Fed. 2nd, 182.

6. The Court in *Carroll v. Carroll*, 1853, 16 How U. S. 275, 14 L. Ed 936 held that the duty of the Federal Courts to follow state court decisions extends only as far as the rules of *stare decisis* permit, and since dicta i.e. expressions not necessary to the actual decision of the controversy before the Court have no value as binding precedents in common law Courts, a Federal Court is not required to follow dictum in a State Court decision.

The *Malott* case was not followed by any other case reported as to the trustee doctrine where the county acquires title to lands through tax deeds. It was, however, mentioned in other cases such as *River Farms of California v. Gibson, County Treasurer*, 42 Pacific 2nd 95 (1935). By statute, the county treasurer was creating a trustee of the irrigation district funds as well as for sale and for redemption of the lands from tax liens. The case cites with approval the doctrine of the Supreme Court of Montana in the *Malott* case but an examination of the facts and matter for decision before the California Court and *Malott* case facts and the doctrine set forth therein are entirely different.

In the Utah case, *State v. Salt Lake County*, 85 Pacific 2nd 858 (1938), the Utah Court refused to follow the doctrine of the *Malott* case in the following language:

“Court decisions are authoritative only upon questions of law or facts actually presented, discussed and decided.”

In a subsequent decision of the Supreme Court of Montana, *State ex rel. Malott v. Cascade County*, 22

Pacific 2nd 811, 94 Montana 394 (1933), in which the sole question was the right of the county treasurer to assign tax certificates of sale to a private person who purchased to take tax title to the land and wipe out the lien of irrigation district bonds. The Court held this could not be done, and in its decision cited the *Malott* case 89 Montana 37, 296 Pacific 1, with approval, but in its decision it referred to *debenture certificates* which in this particular case had been issued by the county to the irrigation district. In this case now before this Court there were no *debenture certificates* involved. The decision above referred to specifically holds:

“If the land would sell for an amount in *excess of the taxes and assessments* * * *”

This, of course, was impossible in the instant case. The compensation deposited for the Dawson County lands being \$23,526.00, and for the Prairie County lands, \$7680.00, which were the amounts for which the counties agreed to sell the lands to the United States. Unpaid irrigation assessments totalled \$41,662.98, so that the case is not authority for the trustee doctrine. The statement made pertaining to the irrigation district assessments was not before the Court for decision.

OVERPAYMENT.

We contend there could be no overpayment as to the counties as they sold specific acreages of land for a gross sum of money. No changes or alteration of the

original contract was made at any time by any of the parties. This action was brought and completed to quiet title to the lands as a means of giving the United States a complete and immediate title and possession under the provisions of the Federal Code. The fee was vested in the United States upon the filing of the declaration of taking, the method of payment adopted was by agreement. The condemnation action and award followed the original agreement.

The legal procedure of condemnation was used as a means of determining to whom payment should be made, as well as giving the United States superior rights to the land that could not be obtained under State law as any judgment in a Montana action to quiet title where defendants are served by public process does not become final until one year after the entry of the decree under the provisions of Section 9187 *Revised Codes of Montana 1935*.

The bringing of an action to condemn merely for the purpose of quieting title would not alter or change the original agreement of the parties so that the division of the lands into tracts was merely for the convenience of the agencies of the United States who took possession of the land and used it for their purposes. *Bank of Edenton v. United States*, 4th Circuit, 152 Fed. (2d) 251-4, *Danforth v. United States*, 308 U. S. 271-282, *Oliver v. United States*, 156 Fed. (2d) 281-282.

In the *Danforth* case above cited, "An offer by United States officer to purchase perpetual flowage easement over land for specified amount, in

connection with flood control program, mentioning desire to consummate the purchase by friendly condemnation proceedings, was, when accepted, an agreement to fix the price of the easement at the named figure, and was binding in subsequent condemnation proceeding, notwithstanding attempt of the government to withdraw the offer after acceptance."

The lower Court in its decision and order on September 4, 1947, pages 98 and 99 of the Transcript on Appeal makes this statement:

"The lands embraced in this action were acquired by the Government through an agreement which included total acreage of the purchase and consideration therefor, and also through condemnation proceedings, wherein declaration of taking was filed, (sec. 258a, Title 40, U. S. C. A.), and commissioners were appointed by the court to appraise the lands, which was done in accordance with the terms of the aforesaid agreement of purchase; and thereafter they made their return and awarded as just compensation for the same total acreage the same amount of money as had theretofore been agreed upon between the Government and the defendants herein, Dawson and Prairie Counties, which sum was thereafter deposited in the registry of the court. Final judgment was entered on the awards of the commissioners, and no appeal was ever taken therefrom."

Our contention is that the counties, after the signing of options to the Government, and stipulating with the Government for the purchase price of the acre-

age to be taken were in no position to file in the condemnation action any pleading making changes nor in any way abrogating the contract and agreements made, nor can they seek to have the commissioners appointed appraise the land at any greater value by means of appraising tracts where the total value would exceed the agreed price between the United States and the counties. There could and has been no division of the consideration for the acreage sold.

Conclusion No. 5 of the Court is erroneous in ordering repayment (Tr. 153-154), citing in support of such conclusion the case of *United States v. Miller*, 317 U. S. 369, 63 Supreme Court 276, 87 L. Ed. 336, 147 A. L. R. 55 (1943). A close examination of this case shows that there is a very distinct difference of facts in that case and the instant case. In the *Miller* case the Court paid to three respondents upon their application when the action was filed the sum of \$850.00 each as just compensation. The case proceeded to trial and the jury fixed the awards assessing them at a less sum than the sum awarded and paid by the Court. Repayment was ordered by the Supreme Court in the case. Here compensation was fixed on all of the lands sold by the counties to the United States by agreement. There was no trial. The commissioners awarded the sum agreed upon. The division into tracts was made by the agents of the United States. (Transcript pages 103 and 104.)

COLLATERAL ATTACK.

Under our Court decisions after the taking of lands by tax deed, all liens and encumbrances have been extinguished, including prior tax liens. The bondholders are in such a position now and since the counties obtained the lands by tax title no attack can be made except by direct action. Here the Court's order of distribution is a collateral attack on the tax title as an attempt is made to give part of the just compensation agreed upon and deposited in the registry of the Court to appellees who had no lien on the lands or from the funds deposited.

On collateral attack our Court has said in *Richardson v. Lloyd et al.*, 90 Montana 127, 300 Pacific 254 (1931), quoting from page 132, Montana Reports:

“A tax deed operates to divest the original owner of his title to the land. (Sec. 2215, Rev. Codes 1921.) Though subsequent in time, it is paramount in right over the title of the mortgagors, and extinguishes all former titles. (State ex rel. City of Great Falls v. Jeffries, 83 Mont. 111, 270 Pacific 638.)

The general rule is that a tax title cannot be assailed collaterally, but must be attacked, if at all, in a direct action. (37 Cyc. 1490, note 84; 4 Cooley on Taxation, 4th ed., sec. 1408; West v. Negrotto, 52 La. Ann. 381, 27 South. 75; State Mortgage Corp. v. Traylor, (Tex. Civ. App.) 32 S. W. (2d) 887.)”

In the case of *Smith v. Whitney*, 105 Montana 523, 74 Pac. 2d 450 (1937), our Court makes this statement:

“No person may question the validity of a tax sale or deed unless he can first show that he, or those under whom he claims had some title to the property at the time of the sale.”

Citing 26 RCL 446, *Goldsbury v. MacConnell*, 73 Colo. 35, 215 Pac. 872, *Hopper v. Chandler*, 183 Ark. 469, 36 S. W. 2d 398.

ASSESSMENTS AFTER TAX DEED.

No assessments for the irrigation district were made after 1938, hence no right to further assess the lands could be made under Chapter 63 Laws of 1937, as this act was passed to protect future districts to be created. After the law was passed, it had no application to the irrigation district created before its enactment. The title here passed to the United States, April 27, 1942. No further assessments were possible under the express provisions of this statute, 40 USCA 258a.

The Montana Supreme Court has construed Chapter 65 Laws of 1937 in the case of *State ex rel. Osten v. Billings*, 91 Montana 76, 5 Pac. 2d 562 (1931), from which we quote on page 81:

“The validity and effect of the tax deed is to be determined by the statutes in force when the sale was made and not by statutes subsequently enacted, for, except as to governmental agencies, the sale of land for delinquent taxes constitutes a contract between the purchaser and the state, the obligation of which cannot be impaired to the disadvantage of the purchaser by subsequent leg-

isolation. (37 Cyc. 1452; 26 RCL 434; *Prowant v. Smith*, 77 Okl. 257, 188 Pac. 93; *Walker v. Ferguson*, 176 Ark. 625, 3 S. W. 2d 694.)”

“ ‘The right of property acquired by the purchaser at this sale, and the right of redemption remaining to the owner, must both be governed by the law in force at the time of sale. Neither, in our judgment, could be either abridged or enlarged by subsequent legislation. This is unquestionably so as to the right of the purchaser.’ (*Merrill v. Dearing*, 32 Minn. 479, 21 N. W. 721; and see *Johnson v. Taylor*, 150 Cal. 201, 119 Am. St. Rep. 181, 10 LRA (n. s.) 818, 88 Pac. 903.)”

We further quote from the holding of our Court in the title, page 82 as follows:

“We hold that one who purchases a certificate of sale from the county occupies the same position legally as if he had purchased at the sale, provided that at the time he takes an assignment of the certificate of sale from the county the law remains the same as it was when the sale was made. A contractual relation came into being when Corkins, Jones’ predecessor in interest, purchased the certificate of sale from the county. Jones acquired every right Corkins had. Jones therefore became entitled to all the benefits flowing from the certificate under the law existing when the county’s title thereto was acquired by Corkins. (*State ex rel. Davenport v. McDonald*, 26 Minn. 145, 1 N. W. 832; *State ex rel. Stieff v. Bradshaw*, 39 Fla. 137, 22 South. 296.) We do not overlook the fact that the purchaser obtains only the rights of the county, nor do we overlook the possibility that the title of the county, a govern-

mental agency, may be affected by subsequent legislation; but we shall not in this opinion pass upon questions which we deem unnecessary to this decision."

The doctrine of the *Osten* case was followed in the case of *Cascade v. Weaver*, 108 Montana 1, 90 Pacific 2d 164 (1939). In the more recent case of *Hartmann v. The City of Bozeman*, 116 Montana 392, 154 Pac. (2d) 279 (1944), the Court held:

"It is quite evident that in enacting Chapter 63 of the Laws of 1937 the Legislature sought to preserve the lien for certain special assessments not due at the time of the execution of the tax deed. However, it is equally clear that only such installments of 'special, local improvement, irrigation and drainage assessments levied against the property' as become payable *after the execution of the tax deed* are preserved by the statute."

In that case the district was created in 1938 after the passage of the chapter above quoted. The assessments made in 1939 and a tax deed issued in December 1940.

It is clear from the language of the Court that the assessments due after the tax deed followed all such other quoted law. The law being prospective and not retroactive. In the instant case no assessments were levied after the tax deeds were filed. The land became the property of the United States in fee under the provisions of the Federal law and was not thereafter subject to taxes or irrigation assessments.

AGREED PRICE BINDING IN CONDEMNATION ACTION.

The Court found that the counties had offered their tax deed lands to the United States for fixed sums to be paid them for the acreages taken (Tr. pages 103 and 104) and the division into tracts was made by the agents of the Government for their convenience, and made this statement:

“Where the purchase price of property has been agreed upon by the owner and the Government, and the latter should thereafter commence condemnation proceedings, the price agreed upon is still binding upon both parties. *Bank of Edenton v. United States* (4 Cir.), 152 Fed. (2d) 251-4; *Danforth v. United States*, 308 U. S. 271, 282; *Oliver v. United States*, 156 F. (2d) 281, 282;”

The following cases support our case relating to contracts entered into with the Government fixing compensation:

Muschany v. United States, 324 U. S. 49, 89 L. Ed. 744;

Danforth v. United States, 308 U. S. 271-282, 24 L. Ed. 240, 60 Supreme Court 231;

Bank of Edenton v. United States (4 Cir.), 152 Fed. (2d) 251-4;

United States v. North Carolina, 136 U. S. 211, 34 L. Ed. 336;

United States v. Rogers, 255 U. S. 163-169, 65 L. Ed. 566, 41 Supreme Court 281;

Seaboard Airline v. United States, 261 U. S. 299, 305, 67 L. Ed. 664;

Smyth v. United States, 302 U. S. 329, 82 L. Ed. 294.

THE JUDGMENT AGAINST THE UNITED STATES IS VOID.

The deposit in the registry of the Court made at the time of filing the declaration of taking was never challenged by any party herein. The executor of the Robert Henderson estate accepted the amount agreed upon by option with the United States. The counties of Dawson and Prairie stipulated with the United States as to the amounts agreed upon so that the judgment against the United States with interest from July 11, 1944 is erroneous.

The purpose of the statute Section 258a, 40 U.S. C.A., was to enable the Government to enter into immediate possession of the land condemned, save interest on the purchase price and make the purchase money available to the persons entitled thereto.

The present action was to quiet title and there has been a delay in the distribution due to service of process and completion of the title proceeding.

NO REPLY FILED BY BONDHOLDERS.

No reply was made to the answer of Dawson County by the appellees so that the matters therein are now standing as admissions of all facts well pleaded therein under the statutes of Montana, Section 9160 *Revised Codes of Montana, 1935*, and cannot now be challenged by the appellees.

Appellants' answer set up title in the United States to the lands sold by Dawson County described in the declaration of taking deposited in the registry of the

Court. That no person whomsoever, other than appellants, were entitled to the distribution of the said compensation. That the lands were free and clear of all encumbrances whatsoever and that there are no outstanding taxes against the said lands, and that the appellants are entitled to immediate distribution of the compensation deposited as the purchase price of the lands sold.

Anaconda Copper Mining Co. v. Thomas, 48 Montana 222, 137 Pacific 380 (1913).

TAX DEED EXTINGUISHES APPELLEE'S LIEN.

The appellee bondholders are in the same position as a mortgagee who loans money on lands and is compelled to pay the general taxes assessed against the lands or lose his security.

“In the case of *State ex rel. Malott v. Board of County Commissioners*, 89 Mont. 37, quoting from page 93:

‘Under the provisions of section 1928, the school funds of this state may be invested “in first mortgages on good improved farm land in the State of Montana.” But, if a loan is made of school funds upon farm lands, the lands are still subject to taxation, and the State of Montana is obliged to protect its loan by the payment of the taxes levied against the land, or suffer the loss of its security through the taking of a tax deed. The bondholders are in the same situation, and may protect their security by either paying the taxes or redeeming the land at any time prior to the expiration of the period for redemption.’ ”

DISTRIBUTION ERRONEOUS.

Conclusion No. 1 of the lower Court is a far-reaching precedent that if followed by the Court would make it possible for all prior lien holders on the tax deed lands to participate in the sale price of such lands, when sold by the counties, whereby the laws of Montana and its Supreme Court decisions the lien formerly held by such persons had been extinguished by the tax deed, a new title created and the same was declared free of all former liens or encumbrances and not subject to further assessments or levy for prior encumbrances.

Such a drastic holding should not be adopted here, as no effort was made by the bondholders to protect their security in the many ways provided by Montana law. The price agreed upon by the counties and the United States is far less than the value of the lands if sold in the usual manner as provided by the laws of Montana.

The sale procedure of the counties was taken to enable the Government to take over these lands for the purposes provided in the Federal laws pertaining to this class of lands and to re-settle farmers upon irrigated lands by new construction of projects. The record shows the total tax liability including the irrigation assessments not paid by reason of no irrigation or possibility thereof.

If the appellee bondholders had any claim to action to secure payment, it could and should have been made through the Upper Glendive-Fallon Irrigation Dis-

trict which corporation has never been legally dissolved, although not functioning as such since 1927.

CONCLUSION.

1. The judgment entered herein distributes a part of the just compensation deposited in the registry of the Court as the purchase price of lands agreed upon by the owners and the United States.

The Court took the view that appellee bondholders were entitled to all of the compensation above the general taxes which were paid to the counties in this proceeding under decisions of the Montana Supreme Court in which the Court itself stated the matter of division of the sale price of lands, sold by the counties after obtaining title thereto by tax deeds *was not before it for decision*.

The Montana Supreme Court further held the tax deeds in this state freed the lands from all prior liens including prior tax liens and that the lands were not subject to further taxation for irrigation assessments.

It is appellants' contention that such a doctrine and holding should not be followed by this Court as it establishes a precedent not warranted by law or decision, in the division of the amount received by the counties in the sale of tax deed lands to persons whose liens had been prior thereto extinguished by tax deed and who had no claims against the lands sold and hence to the funds that take the place of the lands in this action. The error is plainly that of making

a distinction between irrigation district bondholders and ordinary mortgagees or other lienholders.

2. There is in this case no equity doctrine involved as adopted and found by the Court.

All of the funds deposited represent the value of the land at the time of taking and there is no authority that allows the division of such funds to other than the owner of the lands where as here the lands have been theretofore freed of all liens and encumbrances under Montana law and Court decisions.

3. The appellees had remedies to protect their rights, under Montana law and failed to use any of them and cannot now in law or equity assert a claim to the purchase price of the lands sold to the United States where the same have been legally freed of all claims.

4. The finding of "overpayments" to the counties is erroneous in adopting a division of the lands sold by the counties to the United States which was made without the consent or knowledge or participation by the counties who by agreement sold to the United States a gross acreage for a gross sum all of which sums were due the counties without division into tracts.

It is further erroneous to add interest to the sums paid to the appellant counties as the owners of the lands taken where the purpose of the deposit of the amount of just compensation in the registry of the Court was to obtain immediate possession of the lands

and to avoid interest on the purchase price of the lands.

5. The judgment entered is further erroneous in finding for the appellee bondholders where, in the pleadings filed by them they did not deny, by reply to appellants' answer and petition for distribution, the title of appellants to the lands sold, free from encumbrance, and that such title was free from the claim of any person whomsoever and as owner of the lands appellants claimed the compensation deposited in the registry of the Court.

Appellants were and are entitled to judgment on the pleadings for the amount of the compensation deposited for their lands.

6. The findings submitted by appellants should have been adopted by the Court and judgment entered thereon under the facts of the case and the law applicable thereto.

Dated, Glendive, Montana,
February 23, 1949.

Respectfully submitted,

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Attorneys for Appellants.

No. 11821

United States
Circuit Court of Appeals
for the Ninth Circuit

DAWSON COUNTY, MONTANA,

Appellant,

vs.

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS,
on their own behalf and on behalf of all bondholders
of the Upper Glendive-Fallon Irrigation District of
the State of Montana, and UNITED STATES OF
AMERICA,

Appellees,

and

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS,
on their own behalf and on behalf of all bondholders
of the Upper Glendive-Fallon Irrigation District of
the State of Montana,

Appellants,

vs.

EDNA YALE, ALLEN W. YALE and RUBY YALE,
his wife, and RUTH PETTERSON and HANS
PETTERSON, her husband, THE SCOTTISH
AMERICAN MORTGAGE COMPANY, LIMITED,
UNITED STATES OF AMERICA, DAWSON
COUNTY and PRAIRIE COUNTY,

Appellees.

Appellant's Brief

FILED

MAR 23 1948

Upon Appeals from the District Court of the United States
for the District of Montana

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STATEMENT OF THE CASE

In March, 1940 the Farm Security Administration began proceedings with the Boards of County Commissioners of Dawson and Prairie Counties looking to the purchase of the tax deed lands owned by the respective counties, and on September 5, 1940 Dawson County sold its lands, 4164.69 acres, for the gross sum of Twenty-three Thousand Five Hundred Twenty-six and No/100 Dollars (\$23,526.00). Under this sale option the United States went into possession of the lands described and removed fencing, buildings and other obstructions in order to develop the lands under the joint plan of the Bureau of Reclamation and the Farm Security Administration, under the newly organized Buffalo Rapids Irrigation District within which all of said lands were to be included. The public corporation hereinabove named was organized on March 19, 1938, including 17,000 acres of land to be developed by new canals and laterals, under the Bureau of Reclamation and the presidential letter of June 16, 1937 in which the plan of construction was outlined. At the time of the creation of this corporation all of the lands involved in the Upper Glendive-Fallon Irrigation District were eliminated on account of the lack of title by the counties, the tax deed proceedings not having been completed.

The Declaration of Taking filed in this action on April 27, 1942 vested title in 5788.21 acres of land, for-

merly a part of Dawson and Prairie Counties, Montana, in the United States of America under Section 258a, Title 40, U. S. C. A. The compensation deposited in the registry of the Court amounted to \$34,489.00, with valuations on the tracts described therein as follows:

Dawson County, Montana	4164.69 acres	\$23,526.00
Prairie County, Montana	1309.60 acres	7,680.00
Robert Henderson estate	158.60 acres	2,100.00
Edna Yale	103.55 acres	758.00
Scottish-American Mortgage Co.	51.77 acres	425.00

The Declaration was made by the Secretary of Agriculture and was recorded in the two counties, as well as being filed in this Court, with maps of all of the separate tracts therein described attached thereto. With the exception of the Robert Henderson estate lands, the Edna Yale tract and the Scottish-American Mortgage Co. tract, the lands were all a part of the Upper Glendive-Fallon Irrigation District, created as a public corporation of Montana on December 20, 1920 and never legally dissolved, although not functioning as such under the laws of Montana since 1927. Commissioners were appointed by the District Court and qualified as such and thereafter levied assessments for the maintenance and operation of the District by resolution passed in conformity with Chapter 148, Laws of Montana

1921, fixing the irrigable area in each forty-acre tract in said District and levying assessments on such tracts as by law provided. No other or further resolution was ever passed by the Board of Commissioners changing the irrigable area of the lands in the District, and the same became fixed, under the provisions of Chapter 157, Laws of Montana, 1923, page 477. After these assessments were levied for operation and maintenance a bond issue was authorized and approved by the District Court on December 2, 1922 and in the order confirming the bond issue, provision was made for the levy of assessments for the payment of interest and principal of the bonds. Of the issue of \$150,000 authorized there were sold to the public \$81,500, the principal of which is still outstanding and unpaid, as well as accrued interest since January 1, 1928. The funds were to be used in purchasing a pumping plant, a coal mine, and for the construction of canals and laterals to irrigate the lands in said District under two lifts, a forty-foot lift and a seventy-five foot lift, neither of which lifts ever successfully functioned.

Assessments were made by resolution by the Board of Commissioners for the years 1922, 1923 and 1924. Thereafter the County Clerk of Dawson County, on advice from the State Board of Equalization of Montana, entered in each year the same assessment in amount as previously made by the Board of Commissioners. This was done for the years 1925, 1926 and 1927. The Public Service

Commission of Montana took over the levying of assessments in 1933, in accord with the 1921 Montana Code provisions. The law in force and effect prior to such levy so made by the Public Service Commission of Montana was amended in 1931 by Chapter 89, and on pages 167 and 168 thereof authorized the Board of County Commissioners of the county in which the district is situated to levy assessments, if the Board of Commissioners failed to do so, with this proviso:

“Provided, however, that this Act shall apply only to irrigation districts having a bonded indebtedness and actually in operation of a dependable water supply system and furnishing substantial amounts of water to bona fide users.”

The Upper Glendive-Fallon Irrigation District did not possess any facilities for furnishing water to the landowners in the District for their irrigable lands at any time or at all. Assessments were made from 1931 to 1938, inclusive, at the same rates by the Public Service Commission, notwithstanding the above Code provisions, and it appears, therefore, that none of the assessments and levies so made are valid, but all of the assessments so levied were included by the Counties of Dawson and Prairie in taking tax title by tax deed procedure for all of the lands involved in this action. Such deeds were taken in 1931 and 1939. No irrigation taxes were levied after the execution of the tax deeds to Dawson County, Montana.

SPECIFICATION OF ERRORS RELIED UPON

Appellant intends to rely on this appeal on the contentions that the District Court of the United States for the District of Montana, being the trial court below, erred:

1. In adopting the so-called "Equity Rule" in making distribution to the bondholders of the Upper Glendive-Fallon Irrigation District, for the reason that the said bondholders had no lien on the lands involved herein, title to the same having passed to Appellant by tax deeds, which under Montana law created a new title in Appellant, free and clear of all liens and encumbrances against the land. (Paragraph 2, Lines 16 to 24, inclusive, Page 3, Decision of the Court, filed September 4, 1947).

2. In finding an overpayment to Appellant (Page 8, Paragraph 1 of Page 9, Lines 1 to 4, inclusive, Decision of the Court, filed September 4, 1947), the same being in conflict with that part of the Court's decision set forth on Page 6, Paragraph 3, Lines 11 to 24, inclusive.

3. Distribution of the funds in the registry of the Court, as ordered in Paragraph 1, Page 9, Lines 5 to 16, inclusive, Decision of the Court filed September 4, 1947, is improper, being in fact a collateral attack on the tax title of Appellant to the lands, contrary to all of the provisions of Montana law relating to tax deed titles.

Exceptions to all of the foregoing were allowed counsel by the Court in its decision of September 4, 1947.

ARGUMENT

It will be noted that ~~prior to the enactment of this section~~, the Supreme Court of the State of Montana, in its decisions held that:

“General taxes are a prior lien to irrigation taxes, and hence under these decisions, the county acquired a new and paramount title to all of these lands,” (Malott Case 94 Mont. 394)

and it was held by our Supreme Court, in the case of Jensen Livestock Co. v. Custer County, et al., 113 Mont. 285 (124 Pac. (2d) 1013):

“But a tax deed is not derivative, but creates a new title in the nature of an independent grant from the sovereignty, extinguishing all former titles and liens not expressly exempted from its operation. (State ex rel. City of Great Falls v. Jeffries, 83 Mont. 111, 270 Pac. 638; State ex rel. Malott v. Board of County Commissioners, 89 Mont. 37, 296 Pac. 1; Rosebud Land & Improvement Co. v. Carterville Irrigation District, 102 Mont. 465, 58 Pac. (2d) 765.) It is not derived from the fee, but is antagonistic to it and there is no privity between the holder of one and the holder of the other. (Horsky v. McKennan, 53 Mont. 50, 162 Pac. 376.)”

This rule is followed generally throughout most of the states, and in 51 American Jurisprudence, Section 1078, Page 937, the rule is stated as follows:

“As a general rule, in jurisdictions where the tax is a charge on the land alone, where no resort in any event is contemplated against the owner or his personal estate, and where the proceeding is strictly in rem, the title conveyed by the tax deed pursuant to a valid sale of land for non-payment of taxes is not merely the title of the person who was assessed for the taxes and neglected to pay them, but is a new, complete, and paramount title to the land in fee simple absolute, created by an independent grant from the sovereign, which extinguishes all prior titles, rights, interests, and encumbrances of private persons and all equities arising therefrom, not expressly exempted from its operation, although owned or held by persons not liable for the tax or who were not in default for not paying it.”

The bond holders had the right to protect the statutory

lien of their bonds by paying the general taxes assessed for state, county and school district purposes; failing to do so, their lien is extinguished by taking of a tax deed by Dawson County, Montana, a body politic and corporate,

“Antoinette Hartman, Plaintiff v. Della Mim-
mach, etal., Defendants, City of Bozeman, De-
fendant, (154 Pac. (2d) 279).”

wherein the lien of special improvement taxes was extinguished by the execution of the tax deed, as provided in Chapter 63 of the Laws of 1937, hereinabove cited.

Under date of April 27, 1942, in this action, a declaration of taking was filed in the office of the Clerk of the above entitled Court executed by Grover B. Hill, Assistant Secretary of Agriculture; the declaration vested

the fee simple title to all of the said lands in the plaintiff, the United States of America. (Section 258a of Title 40, U. S. Code)

We contend there is no trust involved, in so far as the title of Dawson County, Montana, is concerned, to these lands for the reason that Dawson County, Montana, a body politic and corporate, did not sell the lands under the laws of Montana, and they were taken under the superior rights of the sovereign power, the plaintiff herein, for uses authorized by the laws of the Congress of the United States of America.

By reason of the foregoing, the bond holders have no right to the funds; the said funds were not derived from the sale of the lands but paid into the Registry of the Court in conformity with the Board of Commissioners, who fixed the value of the land taken by the United States for the purposes set forth in its FINAL JUDGMENT IN CONDEMNATION entered herein.

We contend that under the provisions of Chapter 100 of the Laws of the State of Montana, 1943, which is a Statute of Limitations, the bond holders are barred from any action contesting the validity of the tax deeds taken by Dawson County, Montana, to the lands involved herein and that by reason of their failure to act within the time prescribed by said Chapter 100, they are now barred from any claim to the proceeds in the Registry of the Court, representing compensation provided by law for the taking

and acquiring of the lands described in plaintiff's complaint, and taken under the declaration filed therein on April 27, 1942. The section reads as follows:

Section 1. "A tax deed duly recorded shall, after two (2) years from the date of (a) recording and (b) also taking possession by the grantee, or his successor in interest, of the land conveyed, be treated and regarded as conclusive evidence of the regularity of the proceedings resulting in the issuance of such tax deed, from the assessment to the execution of such deed, both inclusive, and no action can be maintained to annul or to set aside such tax deed, or assert a title hostile thereto other than that the deed is void because no taxes were delinquent on said lands, or because redemption had been made from such tax sale, unless the action is commenced within two (2) years from and after the recording of such tax deed, and the taking of possession by the grantee, or his successor in interest, no action can be maintained to set aside or annul the same or to assert a title hostile thereto, other than that the deed is void because no taxes were delinquent on said lands, or because redemption had been made from the tax sale, unless the action is commenced within two (2) years from and after the passage of this act."

"The time herein fixed shall, if the acts of (a) recording and (b) taking possession by the grantee are on different dates run from the event last occurring, provided that both acts shall be essential to start the running of this statute of limitations."

Section 2. "All acts and parts of acts in conflict herewith are hereby repealed."

Approved February 26, 1943.

The Declaration of Taking filed in this action by the Secretary of Agriculture used the same acreage of lands owned by Dawson County and fixed the value at the same

price as fixed by the option, Trpp 43, and recognized Dawson County as the owner of said lands. Thereafter, for their convenience, the Secretary of Agriculture or some agency of the United States, divided the 4164.69 acres into fourteen tracts, designated by the numbers 494-1 to 491-14, inclusive. Such a division was not a part of Dawson County's option and contract of sale, and the County contends that it is not bound by the separation of its lands sold and taken by the United States into tracts but that it has a right to rely upon the taking of the gross acreage owned by it by the United States, which became the fee owner under Federal law, taking full possession of all of said lands for its purposes set forth in the Declaration of Taking.

Dawson County claims the full compensation for this acreage as the owner thereof recognized as such by the Supreme Court of Montana and the Federal Courts.

State ex rel Malott v. Board of County Commissioners of Cascade Co., 89 Mont. 37, 296 Pac. 1.

Quoting from page 95 of said case:

"We are satisfied that the rule heretofore announced by this court in the Cosman Case to the effect that bonds issued by an irrigation district constitute general obligations of that district is erroneous. We are further satisfied that less injury will result from overruling rather than following the doctrine as last above announced; and therefore the former holding of this court to the effect

that such bonds constitute general obligations is overruled. It follows that the lien of the bonds is extinguished by the tax deed to the county, and that the purchaser from the county takes title free and clear of the lien of the bonds."

(Underscoring ours).

Toole Co. Irr. Dist. v. Moody, C. C. A. 9th Dist. 125 Fed. (2d) 498.

None of the landowners of the Upper Glendive-Fallon Irrigation District paid his share of the bonds or interest thereon for the reason that there was never any irrigation.

In 18 Am. Juris. p. 738, Sec. 112, on the title and rights acquired under eminent domain, the following statements are made:

"The appropriation of private property for a public use is generally viewed as a proceeding in rem. The power of eminent domain when exercised acts on the land itself, not on the title or sum of titles if there are diversified interests." Citing in support thereof: Re Third Street, 177 Minn. 146, 225 N. W. 86, 74 A. L. R. 561; State ex rel St. Louis v. Beck, 333 Mo. 1118, 63 S. W. (2d) 814, 92 A. L. R. 373.

Further quoting from 18 Am. Juris. p. 738:

"All inconsistent proprietary rights are divested and not only privies but strangers are concluded. Thereafter whoever may have been the owner or whatever may have been the quality of his estate he is entitled to full compensation according to his interest and the extent of the taking, but the

paramount right is in the public—not as claim under him by a statutory grant, but by an independent title.” Citing in support thereof: Weeks v. Grace, 194 Mass. 296, 80 N. E. 220, 9 L. R. A. (N. S.) 1092; Emory v. Boston Terminal Co., 178 Mass. 772, 59 N. E. 763, 86 Am. St. Rep. 473; Gassaway v. Seattle, 52 Wash. 444, 100 Pac. 991, 21 L. R. A. (N. S.) 68.

In the case of A. W. Duckett v. U. S., 266 U. S. 149, 69 L. ed. 216, 45 Sup. Ct. 38, the Court held eminent domain creates a new title and extinguishes all previous titles. The same ruling was made in Collector of Taxes v. Revere Bldg., 276 Mass. 576, 177 N. E. 577, 79 A. L. R. 112.

In U. S. v. 19.86 acres of land in East St. Louis, Mo., 141 Fed. (2d) 344, 151 A. L. R. 1423, it is said:

“The government in the exercise of its right of condemnation occupies a position different from that of a voluntary purchaser, since condemnation acts upon the res.” (Underscoring ours.)

The Declaration of Taking was not made until April 27, 1942. In the meantime the agencies of the United States had removed the fencing, buildings and other obstructions to its method of irrigating the land taken under said option.

Since the lands involved were not sold under Montana law providing the manner and terms of sale of tax deed lands acquired by the counties, the rule announced by the

Montana Supreme Court in the Malott Cases, 89 Mont. 37 and 94 Mont. 406, does not apply as to the application of the compensation money here involved—the total tax liability being over \$60,000.00, whereas the value fixed by the Secretary of Agriculture in his Declaration of Taking was \$23,526.00.

All of the irrigation assessments made after the passage of Chapter 89, Laws of Montana 1931 are void, as no compliance with said law was made or could have been made. No canals for the delivery of water were constructed and no water supplied, as required by said Chapter, to any landholders, thereby authorizing the Board of County Commissioners to levy assessments where the Board of Commissioners of the Upper Glendive-Fallon Irrigation District failed to do so. The rights of the bondholders were to pay the general taxes before delinquency or to purchase the lands at the sale for general taxes or to redeem the lands from the general taxes, failing in which the bondholders lost all of their rights. This is well illustrated by our Supreme Court in the case of State ex rel Malott v. Board of County Commissioners, 89 Mont. 37, quoting from page 93.

“Under the provisions of section 1928, the school funds of this state may be invested ‘in first mortgages on good, improved farm land in the state of Montana.’ But, if a loan is made of the school funds upon farm lands, the lands are still subject to taxation, and the State of Montana is obliged to protect its loan by the payment of the taxes levied against the land, or suffer the

loss of its security through the taking of a tax deed. The bondholders are in the same situation, and may protect their security by either paying the taxes or redeeming the land at any time prior to the expiration of the period for redemption."

Here the only question, it would seem, before the Court is whether the bondholders at the time of the filing of the declaration of taking had liens upon the property. This proposition has been settled by our Supreme Court many years ago, a distinct holding being in the case of Malott, 94 Montana 394, hence the bondholders could not have had any lien or right or title to any part of the funds. The recent ruling of the United States District Court for Nebraska in the case of United States v 12,800 acres of land in Hall County, Nebraska, appearing in Volume 69 Federal Supplement page 767, states the matter clearly. In this case the Court held at page 771 "Of course, the condemnation award now stands in lieu of the condemned land, and only those who had an estate in that land have any interest in the fund representing this award. See Oliver v. United States, 8 Cir., 156 F 2d 281; United States v. 25,936 Acres of Land, etc., 3 Cir., 153 F 2d 277. Since Tract No. 53 and Tract No. 54 are situated in the State of Nebraska, the law of that state, the *lex loci rei sitae*, governs in deciding questions as to the title and estates or interests in this land. DeVaughn v. Hutchinson, 165 U. S. 566, 17 S. Ct. 461, 41 L. Ed. 827. And the federal court must now be guided by local state law in determining substantive rights in the instant condemnation proceedings,

regardless of how jurisdiction is acquired, United States v. Beckett Co., 8 Cir., 129 F. 2d 473; Swanson v. United States, 9 Cir., 156 F. 2d 443; unless those rights are grounded upon the Constitution or laws of the United States, United States v. Miller, 317 U. S. 369, 63 S. Ct. 276, 87 L. Ed. 336, 147 A. L. R. 55, in which case the federal courts must fashion the governing rules according to their own standards. Cf. Lyeth v. Hoey, 305 U. S. 188, 59 S. Ct. 155, 83 L. Ed. 119, 119 A. L. R. 410; Deitrick, Receiver, v. Greaney, 309 U. S. 190, 60 S. Ct. 480, 84 L. Ed. 694.

It does not appear that Section 258a Title 40 U. S. C. A. or F. C. A. is involved or need be considered in determining to whom the compensation should be distributed. It has been held by the Courts that where an agreement is entered into between a private citizen and the Government, in which the purchase price to be paid for the property by the Government has been fixed and the Government thereafter condemns the property, that the offer made and accepted is binding upon both the Government and the citizen as to the compensation to be paid for the land. The agreement entered into regardless of the action brought to condemn remains binding. See the following cases relating to contracts entered into by Government fixing compensation:

Muschany vs. U. S.

324 U. S. 49

Danforth vs. U. S.

308 U. S. 271-282

Bank of Edenton vs. U. S.
(4 cir.) 152 Fed. 2nd 251-4

Oliver vs. U. S.
(8 cir.) Fed. end, rendered April
9, 1946. Interest not allowable

U. S. vs. North Carolina
136 U. S. 211

U. S. vs. Rogers
255 U. S. 163-169

Seaboard Airline vs. U. S.
261 U. S. 299, 305

Smyth vs. U. S.
302 U. S. 329

In the agreements as a rule there was a clause which provided the Government could condemn if it elected, but this would not affect the provision as to payment of the sum fixed as purchase price. This statute was enacted to make it possible for the Government to enter into immediate possession of the property condemned, save payment of interest on purchase price, and make purchase money immediately available to the persons entitled thereto.

The offer made by Dawson County, Montana, to sell 4, 164. 69 acres of land to the Government for \$23,526.00 did not divide lands into tracts. The offer made was as follows, to wit:

"IT IS HEREBY STIPULATED AND AGREED by and between the County of Dawson, State of Montana, acting by and through the Board of County Commissioners, and the United States that for all purposes of this condemnation proceeding the price and value of Tract No. 494, containing 4,164.69 acres, more

particularly described in the petition filed herein, shall be the sum of \$23,526.00 and that the award of the Court, or any appraisers or commissioners appointed by the court in this proceeding, may be \$23,526.00."

FEDERAL CASES SUPPORT DAWSON COUNTY'S CLAIM TO AWARD

In U. S. v. Certain lands in Town of Hempstead, N. Y. 129 Fed. (2) 918 the court said:

"Where the Federal government acquired title to New York land in condemnation proceedings after the land had been sold to the county for taxes, but before expiration of the period of redemption and original owners did not redeem and tax deed issued to the county, the county was entitled to the entire condemnation award."

In Oliver v. U. S. (C. C. A. 8th) 156 Fed. (2) 281 the court held, that the United States cannot repudiate its contract of purchase and condemnation award follows the contract.

In Oliver v. U. S. 155 Fed. (2) 73, the court held: Contracts between the government and a landowner made in contemplation of acquisition of land by condemnation fixing the value of the land for that purpose are valid.

And further held:

Where the government agency acquiring land for the United States is authorized to acquire it by purchase contract made by it on behalf of the United States with the landowners it may validly fix the net amount to be received

by the landowner either by purchase or condemnation and in such contract the parties may bind themselves to a consideration which may be either greater or less than just compensation in the constitutional sense.

In Florida Beaches v. Niagara Inv. Co. 148 Fed (2) 963

C. C. A. 5th Cir. the holding of the court was;

Where one Florida Corporation had legal title to condemned land and the second corporation asserted an equitable lien or claim thereto, the condemnation fund was ordered paid over to the holder of the legal title without prejudice to an assertion in another court of the second corporation's claimed equitable rights; citing 40 U. S. C. A. 258 A.

(1) CONCLUSION

We conclude by pointing out Dawson County's position in this action. Under all of the decisions of the Supreme Court of Montana, the tax deeds created a new title to the lands in the County, free and clear from all prior liens and encumbrances (Tr. pp 101) Answer of Dawson County not denied by Reply (Tr. p 49 to 51 incl).

The bondholders thereafter had no lien. They failed to pay the general taxes on the lands involved and protect their lien as all mortgagees and other lien holders are required to do or lose all rights in the land. They could have purchased the tax sales certificates and acquired the title to the lands by tax deeds and thus become entitled to all of the funds.

In the decision of the court (Tr. pp 101) there is reference made to a rule citing the Malott Case (89 Mont. 37) we find on close examination of that case it is mere "dicta" as the court itself states the question is not before it but then proceeds to give an emanation of wisdom as to what the law should be, without any citation of authorities to support its statements. However it must be borne in mind that nothing was ever done to carry out the "dicta" of the court in that or any other Montana cases. We contend therefore that the action taken by the government as stated by its counsel was only the usual action to quiet title in which all parties whose names are in the records are made parties without regard to any legal claim or right recognized in law as to their former interest in the lands or present claim thereto. (Tr. pp 104-105)

(2) OVERPAYMENTS

There can be no claim of overpayments to the Counties here as they sold specific acreages to the United States for fixed considerations all agreed to by the parties and without any division into tracts agreed to by the same parties and further agreed that in any condemnation of the lands the awards would be the contract price agreed upon by them. The purpose being to enable the government to take immediate possession of the lands and develop the same according to the plans approved by the agencies of the United States who made these agreements.

In all of the transactions had between the United States

and the Counties the same fixed sum for the same fixed acreage appears so that there was no division into tracts or segregation of the sums to be paid to the Counties. In view of which facts we observe that it is horn book law that the Counties were not thereafter concerned with any division of the lands made by the agencies of the United States and they were estopped to assert any claim to other than the agreed consideration for the acreage sold as the doctrine of equitable conversion took effect immediately upon the option contract being in effect between the parties thereto.

There was no appeal from the Final Judgment as far as the Counties were concerned. They had sold so many acres for so much money and had no right thereafter to alter their contracts with the United States. There can be no overpayment as there was no division of the lands and the prices to be paid therefor between the buyer and the seller. The division of the lands into tracts was for the convenience of the government agencies and could not alter, set aside or hold for naught the contracts previously made between the parties.

(3) DISTRIBUTION OF THE FUNDS

The courts order of distribution is improper being a recognition of a right in the lands involved herein which were lost by the bondholders failure to follow the law of Montana and protect their liens as by law provided. They allowed the lands to go to tax deed and wipe out their lien.

The order of the court amounts to an attack on the

tax title of the counties where none such is permitted by the laws of Montana. The action that could have been taken by the bondholders to protect their lien was never taken. The record shows no taxes were paid by the landowners and no irrigation was ever had (tr. pp 103). We contend the bondholders occupy the same position as a mortgagee who loaned his money on lands and then fails to see that the general taxes are paid and in due course the taxing authorities take over the lands on tax deeds thereby the bondholders the same as mortgagees lose their security Here the bondholders cannot assert their lost lien after 14 years as the tax deeds have wiped out the lien.

We respectfully submit that the Order of Distribution made in the Order and Decision of the Court (TR. pp 109) is erroneous and should be reversed herein and the funds now in the Registry of the Court should be ordered paid to the Counties as the sole owners of the lands involved herein none of which were after the taking of the tax deeds by the Counties subject to any liens or encumbrances whatsoever.

Respectfully submitted:

D. C. WARREN

E. W. POPHAM

Attorneys for Appellant
Dawson County, Montana.

No. 11,821

IN THE

United States Court of Appeals
For the Ninth Circuit

UNITED STATES,

Plaintiff,

VS.

PAUL T. MARKEY, et al.,

Defendants.

DAWSON COUNTY, MONTANA,

Appellant,

VS.

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
on their own behalf and on behalf of all bond-
holders of the Upper Glendive-Fallon Irrigation
District of the State of Montana, and UNITED
STATES OF AMERICA, *Appellees,*
and

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
on their own behalf and on behalf of all bond-
holders of the Upper Glendive-Fallon Irrigation
District of the State of Montana, *Appellants,*
VS.

EDNA YALE, ALLEN W. YALE and RUBY YALE, his
wife, and RUTH PETTERSON and HANS PETTERSON,
her husband, THE SCOTTISH AMERICAN MORTGAGE
COMPANY, LIMITED, UNITED STATES OF AMERICA,
DAWSON COUNTY and PRAIRIE COUNTY, *Appellees.*

Upon Appeals from the District Court of the United
States for the District of Montana.

BRIEF FOR APPELLEES (2nd Appeal)
(Bondholders).

D. J. O'NEIL,

P. F. LEONARD,

Miles City, Montana,

Attorneys for Appellees

(Bondholders) (2nd Appeal).

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COMPANY, LIMITED, UNITED STATES OF AMERICA,
DAWSON COUNTY and PRAIRIE COUNTY,

Appellees.

Upon Appeals from the District Court of the United
States for the District of Montana.

**BRIEF FOR APPELLEES (2nd Appeal)
(Bondholders).**

STATEMENT OF THE CASE.

Appellant Dawson County first appealed from the opinion of the District Court. Now appellants appeal from the final judgment entered pursuant to mandate of the Circuit Court and for the first time Prairie County joins with Dawson County but there is no record of any pleading or showing on behalf of Prairie County in the lower Court.

In their statement in the last brief appellants contend that this entire law-suit is merely to quiet the government's title pursuant to contract for sale and to gain immediate possession. The prior statement of Dawson County and the prior record are also relied upon.

Appellees again controvert such statements as unfounded in fact and the record. It is admitted this is a condemnation suit by the United States under Title 40, Section 258-a, U.S.C.A. A fair statement of the facts is set forth in appellees first brief. There was no contract of sale and none was offered in evidence. The true facts so far as shown of record are set forth in the finding of the District Court :

“12. It appears from the evidence that Dawson County did have negotiations with the Government for the sale of the land in question but the County was unable to deliver satisfactory title to the Government and hence the condemnation proceedings resulted. The negotiations for the sale of the said land from the County to the Government terminated.” (Sup. Tr. p. 151.)

No exceptions were filed by either county to such finding. (Montana Code, 1935, Sec. 9371.) It conforms to the facts and should not be set aside on the mere statement of appellants.

The only so called "sale" proceedings or "contract" are those presented by Dawson County as a part of its answer and set forth as Exhibit A thereto, transcript pp. 51 to 64. A contract requires at least two parties. Here the county merely expressed its willingness to sell but the United States never agreed to buy or become bound to buy through contract.

The United States could not have bought the land without being subject to annual assessments due and likely to accrue of the Upper Glendive-Fallon Irrigation District under Chapter 63 of Montana Laws 1937. The resolution of Dawson County authorizing the sale of the tax lands and the notice of sale were necessary preconditions to any sale of tax deed lands and each prescribed that the sale of said lands would be "subject to the lien of the unpaid balance of certain bonds issued by the Upper Glendive-Fallon Irrigation District".

The problems confronting the government regarding the taxes and irrigation bonds are set forth in the letter of the committee dated May 11, 1935, filed with the Court in response to a request that the tax proceedings be submitted to the Court. Appellants' attorney, D. C. Warren, was one of the signers.

The United States wisely determined to condemn rather than deal directly with the counties as in no

other manner could the lien of the bonds and existing and future assessments for payment thereof be finally excluded or the government in other details obtain clear title.

SPECIFICATIONS OF ERROR (CROSS-APPEAL).

Under their cross-appeal the bondholders maintain the judgment of the District Court is in error, in that:

1. It deprived them of \$758.00 deposited on Yale tract No. 1-27.

2. It deprived them of \$425.00 deposited on Scottish-American Mortgage Co., Ltd., tracts Nos. 1-47 and 1-53, and

3. It deprived the bondholders' attorneys Messrs. O'Neil and Leonard attorneys' fees and expense which should be charged pro rata against the funds protected for the benefit of all the bondholders.

ARGUMENT.

Appellants rehash the legal points previously presented and now present some new theories on the same legal questions.

In its first brief Dawson County (p. 7) claimed there could be no trust in favor of the bondholders because the county—

“did not sell the lands under the laws of Montana, and they were taken under the superior

rights of the sovereign power, the plaintiff herein, for uses authorized by the laws of the Congress of the United States”.

And also it was claimed eminent domain created a new title (p. 11) and

“Since the lands involved were not sold under Montana law providing the manner and terms of sale of tax deed lands acquired by the counties, the rule announced by the Montana Supreme Court in the Malott cases, 89 Mont. 37 and 94 Mont. 406, does not apply as to the application of the compensation money here involved” (Tr. 11-12),

and furthermore, that the rights of the bondholders were barred by Ch. 100, Laws 1943, set forth on page 8.

At no time have the counties objected to the condemnation proceedings. In fact, in its answer (Tr. p. 43) Dawson county

“admits the allegations of the complaint”.

APPELLANTS' THEORIES.

So far as we can determine the present argument of appellants may be summarized as follows:

1st. (a) The counties took and held unconditional title to the lands under tax deeds, and

(b) The bondholders under the irrigation district, like holders of mortgages or prior personal liens, have no right to the lands or the proceeds thereof after tax deeds, and

(c) The counties in taking tax deeds did not act for the irrigation district or the bondholders thereof and may dispose of such lands covered thereby free of any trust for the benefit of the bondholders, and

(d) That the trust theory relied upon and set forth in the *Malott* cases in the Supreme Court of Montana was pure dictum and in preference thereto this Circuit Court should accept the new theories of the appellants, and

(e) That the legislature of Montana could not validly enact Chapter 63 of the Laws of 1937 so as to bind the appellant counties if such Act would in any manner impair the asserted prior rights of such counties.

2nd. (a) That the lands involved were sold by contract by the counties to the United States whereby the acreage and prices were fixed and that the District Court could only follow such "contracts" and erred in allowing refund for over-payment and in making any distribution to the bondholders.

CONTRACT WITH UNITED STATES.

The sale of the tax lands to the government if made would not have changed the obligation of the counties to the bondholders. However the counties had no power to option and the United States did not consent or bind itself to buy. The essentials of a binding contract did not exist.

The "option" to the United States (Tr. 62) or the renewal thereof (Tr. 64) did not make a binding contract upon the government.

As finally determined by the government eminent domain had to be resorted to in order to obtain title. (Finding No. 12, Sup., Tr. 12.) If any contract existed same would have shown and not left to the mere assertion of the appellants. Hence, the assertion that the lands were sold for a lump price without division of acreage is unfounded and contrary to the record as here outlined:

The amended complaint separately described 16 tracts in Dawson County and 8 tracts in Prairie County (Tr. 5 to 11) and detailed in 39 paragraphs the various interests of the separate defendants and the complaint alleged that a declaration of taking had been filed under 258a and demanded the appointment of three commissioners to appraise and determine just compensation for the property.

All of which was agreed to by Dawson County (Tr. 43) and the county then outlined separately as to 14 tracts upon which tax deeds had been obtained the general taxes and irrigation taxes on each separate tract. Appraisers or commissioners were appointed and compensation awarded by them for 17 separate tracts in Dawson County and 7 tracts in Prairie County. (Tr. 69 to 77.) Tract 14 was divided into A and B and Tract 1-12 withdrawn. The Court will observe that the clerk of the District Court served notice of the filing of the return of the commissioners

and after 30 days had elapsed without an appeal from the awards of the commissioners as to the respective tracts (see 9946-9947 *Montana Code*) the Court entered final judgment of condemnation describing the 17 tracts separately in Dawson County and the 7 tracts in Prairie County and adopted the awards of the commissioners for each tract and adjudged the separate awards just compensation for same. (Tr. 78 to 90.) This final judgment was made and entered on December 5, 1945.

On petition of Dawson County an ex parte and preliminary order for distribution was made and entered on July 11, 1944, and prior to the appraisal filed October 1, 1945, whereby it was held that there was due Dawson County for general taxes, at the time it took tax deeds for the separate tracts included in 494-1 to 494-14, the sum of \$10,628.57 and that there were then due assessments for said irrigation district the sum of \$41,662.98 and the general taxes in said amount were ordered paid out of the deposit to said county and the remainder ordered impounded until further order. (Tr. 67.) The tax deeds were issued for both taxes and assessments. (Tr. 44.)

No appeal was taken from such order and the bondholders do not object to the general taxes being paid to the extent of *and in accordance with the awards and final judgment of condemnation.*

After the final judgment in condemnation entered December 5, 1945, Dawson County on June 25, 1946, filed another petition for an order for distribution to

it of the remainder of the deposit claiming it was the record owner of the title to the "Tracts Nos. 494-1 to 494-14B, inclusive, as particularly described in the final judgment in condemnation", and that the deposit was just compensation for the land taken and such petition further recited that the county had been paid out of the deposit \$10,628.57 and the county therein claimed that Chap. 100, Laws 1943, barred all other defendants from any claim to such funds deposited. (Tr. 91.)

In presenting Chap. 100 the county overlooks the fact that the tax deed on the lands here involved was issued to the county upon levies and assessments made for the special benefit of the bondholders for whom the county was acting as agent and trustee. Neither the irrigation district nor the bondholders would have any purpose to attack or assert a hostile title to the tax deed which represented a foreclosure of their own liens for assessments.

The above facts are shown of record and are beyond dispute. The separation of the lands into tracts, the awards and judgment were clearly agreed to by the counties who did not appeal therefrom.

All went fine until it was ascertained the partial distribution on some tracts exceeded the awards thereon which were made nearly 15 months subsequently. Now the counties claim the acreage should not have been separated. But the awards and judgment of condemnation are now final.

SALE OF TAX DEED LANDS BY COUNTIES.

Chapter 171, Laws of 1941, was in force on March 19, 1941, and before the attempted option to the government. (Tr. 64.) Thereby the county was required to enter an order of sale of such lands at public auction and within six months. The notice of sale shall describe the lands to be sold and the appraised value. Section 2 of the Act provides for reservation to the county of not to exceed $6\frac{1}{4}\%$ royalty in minerals. Section 6 of the Act provides that the proceeds of sale shall be distributed by the county treasurer, except for the first \$10, to all funds as the same would have been paid as taxes and if less than the aggregate of taxes and assessments for all funds then such proceeds shall be pro rated between the funds in proportion that the amount of taxes and assessments accrued against such property for each fund bears to the aggregate taxes and assessments for all funds.

Hence, it is readily seen, that the district and the bondholders would have received a much larger share of the proceeds if a sale to the United States under said Act had occurred and proceeds paid, as the irrigation assessments exceeded the general taxes nearly 4 to 1. The law did not grant to the county any right to *option* the lands as only an out-right sale or lease was permitted.

CHAPTER 63, LAWS 1937.

Sec. 1 of Chap. 63, Laws 1937, amended Sec. 2215.9 of the revised *Codes of Montana*, 1935, so as to make certain the existing law, Chap. 176, Laws 1933, included irrigation and drainage assessments as special or local improvements.

The section now reads:

“The deed hereafter issued under this or any other law of this state shall convey to the grantee the absolute title to the lands described therein as of the date of the expiration of the period for redemption, free of all encumbrances and clear of any and all claims of said defendants to said action except the lien for taxes which may have attached subsequent to the sale and the lien of any special, local improvement, irrigation and drainage assessments levied against the property payable after the execution of said deed, and except when the land is owned by the United States or this state, in which case it is prima facie evidence of the right of possession accrued as of the date of expiration of such period for redemption.” (See 104 Mont. 420, 67 Pac. (2d) 989.)

Nearly all the land involved herein went to tax title on December 11, 1939. (Tr. 97.)

Section 7240.1 requires the county commissioners to levy irrigation taxes and assessments where the district omits to do so. In addition the proceedings in Montana in obtaining tax title are extremely technical as shown by the case entitled *Jenson Livestock Co. v. Custer County, et al.*, 114 Mont. 285, 124 Pac. (2d) 1013, cited on p. 5 of appellants' first brief. Hence,

it was logical in view of all the foregoing that the officers representing the United States could not risk accepting or closing the offered option and decided to condemn. The appellants have cited *State ex rel. Osten v. Billings*, 91 Mont., 76; *Cascade v. Weaver*, 108 Mont. 1, and *Hartmann v. Bozeman*, 116 Mont. 392, under their claim that the said Act did not apply to the irrigation district in question created before the Act. However, the *Osten* case (Appellants' Brief at pp. 22 and 23) expressly held: That subsequent statutes do apply "to government agencies", and the title of the county as a governmental agency may be affected by subsequent legislation. Each of the three cases cited involved private vested rights which could not be impaired. In this case the trial judge properly held (Sup. Tr. 152) the counties have no power excepting that conferred by law as they are pure creatures of the law subject to legislative control without having constitutional restrictions against legislative enactments under the rule approved in:

Franske v. Fergus County, 76 Mont. 150;

Yellowstone Packing Co. v. Hayes, 83 Mont. 1,
and

State v. Holmes, 100 Mont. 256.

OVERPAYMENT.

The specific amounts of general taxes paid Dawson County were based upon the evidence presented by it and shown in its answer. (Tr. pp. 46, 47 and 48, see also original Exhibit No. 1.)

In making advance distribution long before the awards of compensation and judgment fixing same the District Court overpaid but in its final judgment (Sup. Tr. p. 147) correction was made showing Dawson County over paid out of the deposit to the extent of \$3315.06 and Prairie County in the sum of \$327.86. The appellants do not dispute the figures and it is evident the awards, as found by the Court, were to that extent less than the payments made to the counties and hence the deficiency.

This particular question is fully covered by Section 258a, which reads:

“Upon the application of the parties in interest, the court may order that the money deposited in the court, or any part thereof be paid forthwith for or on account of the just compensation to be awarded in said proceeding.”

And the statute further provides:

“If the compensation finally awarded in respect of said lands, or any parcel, thereof, shall exceed the amount of the money so received by any person entitled, the court shall enter judgment against the United States for the amount of the deficiency”.

The Court is also given express authority to make such orders in respect to liens “as shall be just and equitable”.

The deposit made is only an estimate and the final awards could easily be more or less than estimated and, in respect to the deposit and declaration of taking with passing of title, the Federal procedure is entirely

different from the eminent domain law of Montana where deposit is never made and in no event does title pass until after the award and final order of condemnation. See 9946 to 9952 Montana 1935 Revised Codes.

The case of *United States v. Miller*, 317 U.S. 369, 87 L. Ed. 336, 147 A.L.R. 55, involved a condemnation for benefit of Central Valley project in California and deposit was made as estimated compensation for a tract belonging to three co-tenants in sum of \$2550.00 and forthwith \$850 was paid to each of them but the award and final judgment were for less. There judgment was entered in favor of the United States for amounts paid in excess of the awards. Here the compensation finally awarded the bondholders on the lien claims under their bonds exceeded the moneys left on deposit for them to the extent of \$3642.92 and hence it was proper for the Court to enter a judgment against the United States for such deficiency for the protection of the bondholders. If such money is not on deposit it cannot be paid the bondholders and to deprive them of their money with interest from July 11, 1944, would be taking their property for public use without just compensation in violation of the Fifth Amendment of the Constitution. The full details thereon are shown in finding of fact No. 5, pp. 146-148 Sup. Tr. and conclusion No. 5, same pp. 153-154.

In the *Miller* case the Supreme Court held:

“Notwithstanding the fact that the court released the fund to the respondents, the parties were still before it and it did not lose control of the fund

but retained jurisdiction to deal with its retention or repayment as justice might require.”

The counties demanded advance payment on the undisputed theory that the general taxes due should be paid which was done with the knowledge and without objection of the government attorney, and the government was fully protected by the further judgment that the counties return such excess payments with interest to the registry of the Court.

In what other manner could just compensation have been paid the bondholders or the Court have made an order which would have been just and equitable? Section 258a gives the District Court full power to forthwith on application of the parties in interest pay out the moneys deposited but authorizes judgment against the United States for the deficiency on the compensation finally awarded. The counties and the attorney representing the United States were advised when the order of July 11, 1944, was made but the bondholders were not present or obligated.

RELATION OF BONDHOLDERS TO IRRIGATION DISTRICT AND THE COUNTIES AND THE LANDS INVOLVED.

The deposit made by the government and the awards of compensation stand in place of the property. No question exists or has been raised as to the right of eminent domain. The compensation is distributed under the law according to the rights of the parties interested “as shall be just and equitable”.

The appellants in their brief and Dawson County in its previous brief attempt to completely ignore the irrigation law of Montana and confine themselves to claiming the views of the Supreme Court of Montana in the *Malott* case in 89 Mont. 37 were dicta. Between pages 12 to 26 of their first brief on appeal the bondholders have outlined the rights under irrigation districts in Montana as particularly related to the bondholders thereof. Appellants have not controverted same.

In tax proceedings there is only one deed on foreclosure wherein the county and its county treasurer acts for the benefit of the funds involved. Under the general law, as shown by Chapter 171, Laws 1941, as will be seen by reference to Sections 2234 and 2235 of the 1921 Code and 1935 Code of Montana in case of redemption or sale of lands acquired under tax deeds the county must apportion the proceeds to the funds according to the levy, and it results the county acts merely as trustee. That was the rule adopted in *State ex rel. City of Wolf Point v. McFarlan*, 78 Mont. 156, 252 Pac. 805, and *School Dist. No. 12 v. Pondera County*, 89 Mont. 342, 297 Pac. 498.

In like manner and under special statutes the rule applies even stronger in irrigation districts.

It is unnecessary to repeat the Montana irrigation law as same appears in substance in Part III of appellees' original brief and see the copy of district proceedings in bondholders original exhibit No. 3. We do call attention to the fact Section 7213 of 1935 Code in force at all times makes the bonds of the district

a lien "upon all the lands" "in the district" and they are "subject to a special tax or assessment for the payment of the interest on and principal of said bonds" and "shall constitute a first and prior lien on the land against which levied, to the same extent and with like force and effect as taxes". And Section 7232 of the same Code provides all bonds "shall be paid by revenue derived from a special tax or assessment levied as hereinafter provided upon all the lands included in the district" and the district board is required in the resolution for the issuance of the bonds to provide for an annual levy and file a copy thereof with the county commissioners and "when so collected shall by the county treasurer having custody of the funds of the district be placed in a *special fund and used solely*" * * * "*for the payment of the interest on and principal of said bonds when due*". Sections 7243 to 7246 of the 1935 Code provide for the full protection of such irrigation assessments even when the county acquires the lands of the district for taxes.

Hence in the *Malott* case reported in 89 Mont. 37, it was necessary to review the rights under Montana irrigation districts and in view of the general and special statutes the Court properly held at page 95 that the county acted as agent and held the tax title as a trustee and that the moneys derived from sale of such lands would be trustee funds for the benefit of the bondholders pursuant to the statute and thus give them the benefit of their security.

The counties could not even under the general law (Chap. 171, Laws 1941) claim more than a proportion-

ate part of the proceeds and here under the order of July 11, 1944, having been paid the full amount of the general taxes, why should they be permitted to violate their trust and take all the proceeds? The specific irrigation assessments formed the foundation for the tax deeds and they were levied to create a special fund to be *USED SOLELY* for the payment of the interest on and principal of the said bonds. (Section 7232.) As well said by the Supreme Court of Montana in the case of *State v. Board of County Commissioners*, 86 Mont. 595, 285 Pac. 932, to permit the board of county commissioners to frustrate payment of the bonds of an irrigation district from the lands thereof "would work a manifest fraud and injustice upon innocent parties who have honestly and fairly parted with their money in reliance upon the faith and credit of the irrigation district and the protection afforded by the laws of the state."

This same view was repeated in *State ex rel. Malott v. Cascade County*, 94 Mont. 394, 22 Pac. (2d) 811 through a changed Court and wherein the irrigation district law was reviewed and the Court said:

"the county occupies the position of a trustee for the interested parties, including, of course, the bondholders" * * * "The county, as trustee, cannot lawfully do anything adverse to the rights of the bondholders, beneficiaries under the trust".

The Court also said:

"when irrigation district lands are struck off to the county and under statutory direction deben-

ture certificates have been issued therefor, the county becomes a trustee and never discharges its trust until the lands are redeemed from sale, or, if not, until it sells the lands and distributes the proceeds agreeably to equity.”

and as to the county,

“After issuing the debenture certificate it can perform but two acts (or related acts) with respect to the lands: (1) Receive money paid upon redemption and distribute the same; (2) obtain a deed to the lands, sell the same, and distribute the money received upon the sale”.

The Court there held that no course could be taken by the county which would set at naught Sections 7213 and 7232 which became a part of the contract when the bonds were sold and it was held that upon sale of the lands in the irrigation district the excess over the taxes could not be credited to the general fund of the county. It was held the excess on the sale must go for the benefit of the bondholders.

Official duty is presumed done and the counties cannot assert a statutory ministerial duty was not performed. Sec. 10606 Montana 1935 Code. *State ex rel. Wolff v. Guerkind*, 109 P. (2d) 1094. (Mont.)

The Supreme Court of Montana merely applied the irrigation district law which is still in force and the statutory law and judicial interpretation thereof by the highest Court of Montana were properly applied in this case by Judge Pray who is very well informed as to the law of Montana.

The rather late case of *State ex rel. v. Rorabeck*, 111 Mont. 320, 108 Pac. (2d) 601, involved payments due on bonds of an irrigation district and was decided by an entirely different Court and the trustee rule was again followed. The Court said:

“The principal and interest on the bonds were payable out of a particular fund exclusively, of which the county treasurer was custodian. (Secs. 7213, 7232, Rev. Codes 1921.) The officers of the irrigation district who must provide for the levy and collection of a tax sufficient to meet the interest and principal, and the county treasurer who is made the custodian of the funds of the district, stand in the relation of trustees *for the bondholders of the district.*”

Here appellants assert the bondholders had the right to protect themselves by paying the taxes and assessments but the Court said in the last cited case:

“In the case at bar the fund cannot be replenished by further assessments (*State ex rel. Malott v. Board of County Commrs.*, 89 Mont. 37, 296 Pac. 1), and the only method of obtaining additional funds is by the sale of the lands to which tax titles have been taken. This is at best an uncertain and unreliable source of income.”

In *Rosebud Land & Improvement Co. v. Cartersville Irr. Dist.*, 102 Mont. 465, 58 Pac. (2d) 765, the Montana Court reviewed the *Malott* case and re-affirmed same.

This Circuit Court in *Judith Basin Irrig. Dist. v. Malott*, 73 F. (2d) 142, 97 A.L.R. 504, made a complete

analysis of our irrigation law which is applicable excepting appellees do not claim their bonds are equal to the lien of general taxes, but that decision was distinguished in *Toole County Irr. Dist. v. Moody*, 125 F. (2d) 498 where this Circuit Court again construed Montana irrigation law and followed the ruling in the *Malott* case. Here appellees do not contest either the *Malott* case or the last case cited.

REPLY.

Appellants also claim no reply was filed to the answer of Dawson County. It is admitted all the parties followed the practice outlined in the Federal Civil Rules and no reply would have been permitted as we view Rule 7.

However the answer of the county was to the amended complaint and admitted the allegations thereof but did set up in detail as its "Exhibit A" what was designated in paragraph 1 as "*an offer in writing to sell to the United States*". The offer is a matter of record and could not be denied. Calling it a "sale" does not make it so or bind the United States. The answer did not allege any defense or counterclaim to the condemnation or any cross complaint *against either the United States or the bondholders*. It is true that the answer of the bondholders improperly in the eminent domain proceedings sought an accounting against the county, as the Federal District Court could only condemn, fix the compensation and

distribute the money. The condemnation and compensation were not disputed by any defendant and the entire question before the trial Court related largely to questions of law as to distribution and separate petitions for distribution were filed by the county (Tr. 91) and by the bondholders. (Tr. 94.)

The Court will observe that the petition of the bondholders conceded the general taxes mentioned be paid the counties from the deposit and demanded that the counties refund and repay to the registry of the Court the sums improperly withdrawn and that the remainder be distributed to the bondholders pro rata after payment of reasonable attorneys' fees.

If the law of Montana on eminent domain governs then we find the pleadings detailed by Sections 9940 to 9942 of the 1935 Montana Code and the only pleading authorized for the defendants is set forth in Section 9942 as follows:

"All persons named in the complaint, in occupancy of, or claiming an interest in, any of the property described in the complaint, or in the damages for the taking thereof, though not named, may appear, answer or demur, each in respect to his own property or interest."

Here both the county and the bondholders did set up their own claim of interest which is all the law permits.

CROSS-APPEAL.

There is no authority for the Honorable District Court excluding the lien of the bondholders from the tracts known as Yale No. 1-27 and Scottish-American Mortgage Co. No. 1-47 and 1-53 on which awards total \$1183.00.

The facts regarding such tracts are fairly set forth in the trial Court's findings Nos. 10 and 11. (Sup. Tr. 150-151.) Such lands were included in the irrigation district and never excluded. The formation of the district, the lands included and whether susceptible of irrigation were all questions within the exclusive jurisdiction of the state Court based upon evidence including that of the State Engineer (Sec. 7166), and it is now far too late for the trial judge to change the boundaries of the district or exclude such lands as directed under conclusion 5 (Sup. Tr. 153) and by the judgment. (Sup. Tr. 155.) See *Krueger v. Morris*, 110 Mont. 559.

We dislike to again mention our attorneys' fees and expense. The trial judge did find that *as attorneys we have expended much labor and expense for the bondholders which will inure to the benefit of all the bondholders* if compensation be made them from the moneys on deposit. We protected this fund. And if all the bondholders share in the fruits of this litigation there is justice in requiring all to share pro rata in payment of reasonable fees and expense if our labors have resulted in preserving a common fund. The rule is outlined in numerous cases cited in 107 A.L.R. 749.

Here, as shown by the record, we appeared for all the bondholders and under Section 8993 Montana 1935 Code the law gives us a lien upon the judgment. No other attorneys represented the bondholders and it would be inequitable to permit the bondholders to share pro rata in the benefits without contributing to the expense. The correct rule was adopted by Judge Pray in *United States v. Hudson*, 39 F. Supp. 797. See appellees' prior brief p. 30.

CONCLUSION.

The judgment of the District Court should be affirmed excepting as to the items covered by the cross-appeal, wherein it should be reversed.

Dated, Miles City, Montana,
March 25, 1949.

Respectfully submitted,

D. J. O'NEIL,

P. F. LEONARD,

Attorneys for Appellees

(Bondholders) (2nd Appeal).

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

UNITED STATES,

Plaintiff,

vs.

PAUL T. MARKEY, et al.,

Defendants.

DAWSON COUNTY, MONTANA,

Appellant,

vs.

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
on their own behalf and on behalf of all bond-
holders of the Upper Glendive-Fallon Irrigation
District of the State of Montana, and UNITED
STATES OF AMERICA, *Appellees,*
and

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
on their own behalf and on behalf of all bond-
holders of the Upper Glendive-Fallon Irrigation
District of the State of Montana, *Appellants,*
vs.

EDNA YALE, ALLEN W. YALE and RUBY YALE, his
wife, and RUTH PETTERSON and HANS PETTERSON,
her husband, THE SCOTTISH AMERICAN MORTGAGE
COMPANY, LIMITED, UNITED STATES OF AMERICA,
DAWSON COUNTY and PRAIRIE COUNTY, *Appellees.*

Upon Appeals from the District Court of the United
States for the District of Montana.

BRIEF FOR APPELLEES
(Bondholders).

D. J. O'NEIL,

P. F. LEONARD,

Miles City, Montana,

*Attorneys for Appellees
(Bondholders).*

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No. 11,821

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

UNITED STATES,

Plaintiff,

vs.

PAUL T. MARKEY, et al.,

Defendants.

DAWSON COUNTY, MONTANA,

Appellant,

vs.

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
on their own behalf and on behalf of all bond-
holders of the Upper Glendive-Fallon Irrigation
District of the State of Montana, and UNITED
STATES OF AMERICA,

Appellees,

and

MARY HAGAN, E. B. CLARK, and MINNIE R. EVANS,
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District of the State of Montana,

Appellants,

vs.

EDNA YALE, ALLEN W. YALE and RUBY YALE, his
wife, and RUTH PETERSON and HANS PETERSON,
her husband, THE SCOTTISH AMERICAN MORTGAGE
COMPANY, LIMITED, UNITED STATES OF AMERICA,
DAWSON COUNTY and PRAIRIE COUNTY,

Appellees.

Upon Appeals from the District Court of the United
States for the District of Montana.

BRIEF FOR APPELLEES

(Bondholders).

STATEMENT OF THE CASE.

The statement of appellant is controverted.

It is unfounded on the record and confusing. It is necessary a full statement be made.

The United States of America commenced this action to condemn 5,788.21 acres in Dawson and Prairie Counties, Montana. All of the lands involved were in the Upper Glendive-Fallon Irrigation District and the defendants Mary Hagan, E. B. Clark, Minnie R. Evans and other defendants were joined "as lien claimants of the holders of bonds issued" by the said District.

The complaint was filed pursuant to 40 U.S.C.A. 258a with declaration of taking and deposit in the registry of the Court of the estimated value of the lands and immediate possession (Tr. 2-28) was demanded.

The appellees on their own behalf and *on behalf of all other bondholders* of the District filed answer, counterclaim and cross-claim. (Tr. 28-43.)

The appellant county filed answer and petition for distribution. (Tr. 43-64.)

Both answers admitted the allegations of the plaintiff and the necessity of condemnation. (Bondholders Tr. 30 and County Tr. 43.)

Separate tracts and division of the lands according to ownership were outlined in the amended complaint (Tr. 5), answer of the county (Tr. 44), the Commissioner's appraisal (Tr. 69) and in the final judgment in condemnation. (Tr. 78-82.)

Dawson County acquired tax deeds to nearly all of the lands involved on December 11, 1939 (Tr. 97), and the county appraised the various tracts and directed sale and provided:

“And all the above lands described as being in township 13 are *subject to the lien of the unpaid balance of certain Bonds issued by the Upper-Glendive-Fallon Irrigation District, Jan. 1, 1923.*” (Tr. 52-53.)

The notice of sale of the tax title property contained like provision (Tr. 55), for protection of bondholders.

Uncompleted option or negotiations to the United States were also shown in the answer of the county. (Tr. 59-64.)

No question has arisen regarding the creation or organization of the Irrigation District or the validity or liens of the bonds issued. (See Bondholder's Original Exhibit No. 3.) The tax deeds merged the assessments.

The map or plat of the District is original exhibit No. 3 and shows the location and boundaries and the two lifts or elevations, and all lands involved are within the District.

The Irrigation District was established by judgment dated December 20, 1920. (Abstract Bondholders' Original Exhibit No. 3, pages 20 to 23.)

The bonds in question were authorized by judgment of the District Court confirming the issue, made and entered December 2, 1922; \$150,000.00 in bonds were authorized but only \$81,500 sold

“For the purpose of providing funds for the construction of a system of irrigation works for said District including the purchase of a pumping plant and certain coal lands, all in accordance with the Plan of Reclamation for the District approved and adopted by the Public Service Commission of Montana”

and the Court confirmed the bond issue

“and the special tax or assessment levied to pay the said bonds and interest”.

(See Abstract Original Bondholders' Exhibit No. 3, pages 29-41.)

While this action was pending on July 11, 1944 (Tr. 67), before the appraisal filed October 1, 1945 (Tr. 69-77) and prior to judgment in condemnation, December 5, 1945 (Tr. 78-90) the Court ordered paid to the appellant Dawson County from the registry of the Court \$10,628.57, being all of the general taxes set forth in the answer of Dawson County (Tr. 44-49), excepting redemption had been made as to Tract 494-14A (Tr. 67, 82, 86), and the general taxes thereon of \$249.68 were not claimed by the county.

The assessments levied for the District up to 1938 and included in the tax deeds appear in the answer of the county (Tr. 44-49) and in the *ex parte order* of partial distribution on general taxes *obtained by the county* as “*delinquent, unpaid assessments made and unpaid on account of*” said district amounting to \$41,662.98.

The District Court (Tr. 100) ruled as to the Yale Tract No. 1-27:

“it does not appear that it was susceptible of irrigation, was ever assessed for that purpose, or that it was obtained from either of the counties, or that the irrigation district or bondholders have any lien upon the compensation of \$758 deposited in the registry of the court to the credit of this piece of land.”

The tract is described in the complaint (Tr. 8) in the appraisement of the Commissioners (Tr. 76) and the judgment of condemnation (Tr. 82, 86). The large map, Exhibit No. 3, shows that land within the boundaries of the District, and it is described in the judgment creating the District. (Bondholders' Original Exhibit No. 3, Abstract at page 22.) It was never excluded or withdrawn from the District. The petition for creation of the District, Bondholders' Original Exhibit No. 3, page 3, shows that the west half of Section 16 Township 13 north, range 53 EMPM, was assessed to Fred Yale, one of the petitioners creating the District. He sought to withdraw his name from the petition, same Exhibit at page 19, but notwithstanding the land was included, same Exhibit at page 22, and he was appointed one of the District Commissioners, same Exhibit at page 23, and he signed petition for issuance of the bonds in question, same Exhibit at pages 29 and 30, and as president presented the resolution for the issuance of the bonds, same Exhibit pages 31 and 36.

The District Judge also held:

“The land designated as the Scottish-American Mortgage Co. tract, Nos. 1-47, and 1-53, for which

\$425 was deposited in the registry, does not appear to have been legally embraced in the irrigation district in the absence of notice or consent, and that upon foreclosure in which the irrigation district was included as a party defendant, no claim of lien or otherwise was made by such defendant. The irrigation district and the bondholders do not appear to have any interest in the distribution of this fund.” (Tr. 100.)

The lands described as tracts Nos. 1-47 and 1-53 were described in the amended complaint as:

“Lot Four (4) and the Northeast quarter of the Northeast Quarter ($NE\frac{1}{4}NE\frac{1}{4}$) of Section Fourteen (14) in Township Thirteen (13) North of Range Fifty-three (53) East of the Montana Principal Meridian, Montana.” (Tr. 9.)

The large map, Original Exhibit No. 3, shows the lands within the boundaries of the District and also in Bondholders' Original Exhibit No. 3 at page 3, in petition to organize the District, and Mary E. Lewis was the owner of the property according to the last previous assessment rolls of Dawson County. She made an appearance and protested the inclusion of said lands in the District, same Exhibit at page 15, and also appeared through her attorney at the hearing, same Exhibit at page 20, but the Court ordered the District created after considering the evidence including the report of the State Engineer and adjudged that the lands were susceptible of irrigation from the same general source and the same system and included said land within the District. Same Ex-

hibit at page 22. No appeal was perfected from said judgment.

Dawson County on July 11, 1944, received full payment of its general taxes (Tr. 67) but in this appeal claims all of the compensation and seeks to deprive the bondholders, as lien claimants, of any portion thereof.

The preliminary order of distribution (Tr. 67) paid Dawson County \$3315.06 (Tr. 108) in excess of the final appraisement (Tr. 69) and final judgment. (Tr. 78.)

The Court ordered refund under Section 258a from the Counties and directed judgment against the United States. Interest is due from at least July 11, 1944.

The final question on the appeal involves the matter of attorney's fees. Mary Hagan, E. B. Clark and Minnie R. Evans are acting not only on their own behalf but also on behalf of all the bondholders of the district (Tr. 28) and their attorneys through their services protected the funds which may be paid to all the bondholders pro rata and they requested an order for reasonable fees payable out of such funds (Tr. 40) but the District Court denied compensation. (Tr. 106.)

SPECIFICATIONS OF ERROR

(Under Cross-Appeal).

1. Yale tract No. 1-27 improperly excluded from irrigation district and deprived bondholders of \$758. (Tr. 100.)

2. Scottish American Mortgage Co., Ltd., tract Nos. 1-47 and 1-53 improperly excluded from irrigation district and bondholders deprived of \$425. (Tr. 100.)

3. District Court erred in not including interest on over-payment or improper withdrawal from deposit per order of July 11, 1944. (Tr. 108.)

4. Court erred in denying fees under equity rule to attorneys representing bondholders to be paid out of common fund protected for all and before distribution. (Tr. 106.)

ARGUMENT.

I.

APPELLANT'S THEORY.

The specification of errors and argument of appellant confines the issue:

1. The county claims it owned the lands involved and that the bondholders have no rights therein or to the proceeds on distribution under 258a, and

2. There was no overpayment and the condemnation proceedings should not have made division into tracts.

It is impossible to follow the argument or conflicting theories of the appellant because on one hand it attempts to claim a sale to the Government and maintains Section 258a does not apply (Appellant's Brief 14) even though the answer of county admitted all the allegations of the government's complaint on condemnation (Tr. 43) and paragraph 2 of the answer alleged that the lands upon which tax deeds were obtained by Dawson County included taxes,

“levied by the State of Montana, Dawson County, Montana, and school districts, and taxes levied by Upper Glendive-Fallon Irrigation District”

The amount of the general taxes and likewise the irrigation taxes of the district are separately set forth in the answer (Tr. 44-49) and they are set forth more in detail in Original Exhibit No. 1.

Under no theory could the county levy assessments for the irrigation district and by reason thereof enforce same through the tax deeds and now question or attempt to repudiate such assessments which were the very foundation of the tax deeds.

It would serve no purpose in this condemnation proceeding to raise any question as to the validity of the tax proceedings which were doubtful. The government obtains the entire title to the land and the county obtains the general taxes from the deposit.

The county was given preference on the general taxes and early in proceedings obtained order for payment. (Tr. 67.)

The county appeals herein to *prevent the bondholders receiving any part of the compensation.*

The priority of general taxes is conceded and hence it is a waste of time to consider the many cases cited by appellant on that point.

The county acted for the district in the levy and collection of taxes. Its present attempt to take *all* the compensation on condemnation is the first and only *hostile* act of the county as against the bondholders. It is admitted by answer of the county and even appellant's brief on page 4 that the assessments for the district were levied and included in taking tax deeds.

II.

APPELLANT'S CITATIONS.

Chap. 100, Montana Session Laws 1943, (p. 8 of brief) limiting the time to attack the validity of a tax deed cannot apply to the public corporation whose taxes or assessments were the basis for the deeds.

The case of *Jensen Livestock Co. v. Custer County, et al.*, 113 Mont. 285, 124 Pac. (2d) 1013, was by private owner to redeem from tax deed and *Hartman v. Mimmack*, 154 Pac. (2d) 279, merely involved assessments for special improvements prior to tax deed BUT held that under Chapter 63 of Laws of 1937 assessments levied or payable after such deed "constitute a lien against the property".

The decisions cited by the appellant are clearly not in point. *In Re Third Street*, 177 Minn. 146, 225 N. W. 86, 74 A. L. R. 561, involves city charter provisions of St. Paul regarding condemnation.

State ex rel. St. Louis v. Beck, 330 Mo. 1118, 63 S. W. (2d) 814, 92 A. L. R. 373, pertains to the question of damages due to delay in condemnation.

Weeks v. Grace, 194 Mass. 296, 80 N. E. 220, 9 L. R. A. (N. S.) 1092, involved the question of whether a covenant or warranty in a deed against encumbrances protects the sovereign power under condemnation.

Gassoway v. Seattle, 52 Wash. 444, 100 Pac. 991, 21 L. R. A. (N. S.) 68, is a limited decision and it was held that it was not necessary to make the county a party defendant on condemnation brought by the city. It was also held that the city having taken the full title the county had nothing to sell under tax proceedings.

Duckett v. U. S., 266 U. S. 149, 69 L. ed. 216, 45 Sup. Ct. 38, was a claim brought against the United States for the value of claimant's interest under lease in the Bush Terminal taken by the President and the Secretary of War for war purposes and the question simply involved the implied duty of the government to make compensation for the value of the lease.

Collector of Taxes v. Revere Bldg., 276 Mass. 576, 177 N. E. 577, 79 A. L. R. 112, involved purely a local question on the collection of taxes.

As explained in the case of *Gassoway v. Seattle*, supra, after condemnation there is no tax and as further explained in *U. S. v. Pierce County*, 193 Fed. 529, the inquiry is always directed to the question of whether the taxes were imposed before or after the acquisition of the property.

Other cases cited by appellant are *Lyeth v. Hoey*, 305 U. S. 188, 59 S. Ct. 155, 83 L. ed. 119, 119 A. L. R. 410, which involved income and gift taxes, and *U. S. v. Miller*, 317 U. S. 369, 63 S. Ct. 276, 87 L. ed. 336, 147 A. L. R. 55, as to severance damages.

III.

RIGHTS UNDER IRRIGATION DISTRICTS.

The appellant not having done so it is necessary to refer to the Montana law regarding irrigation districts, and the rights of bondholders thereunder.

The present Montana law on irrigation districts is found in Section 7166 to 7264.18 of the Revised Codes of 1935. However, the law in force, with some exceptions, at the time of the issuance of the bonds would be found within 7166 and 7264 of the Revised Codes of Montana 1921. Judgment creating district was made December 2, 1920.

Evidence of ownership on petition creating the district under Section 7166 of the 1921 Code was the county assessment roll of the preceding year and that section has since been amended to now require the

consent of a mortgagee on the petition. The history of the law is given in *Toole County Irr. Dist. v. State*, 104 Mont. 420, 67 Pac. (2d) 989. The consent provision as to mortgagee was first enacted as part of Ch. 112, Laws 1925, which was apparently overlooked by the District Judge in passing on tracts 1-47 and 1-53. Exclusive jurisdiction and powers are conferred upon the state District Court and wide discretion is lodged in the Court which hears and determines the issues and then makes findings and order creating the district, if proper. The law directed the Court should not exclude any lands susceptible of irrigation from the same source and system nor include any lands "which shall not in the judgment of the Court, be benefited by irrigation by means of said system of works" and also declared the finding and order of the Court "*shall be conclusive*" and assented to unless appealed to the Supreme Court within 60 days.

The law declared the district a public corporation for public welfare and the lands in the district to constitute the assessable property of the district. (Section 7169, 1921 Code.) Having come into existence the next step was to provide for irrigation which required funds obtainable only through sale of bonds to be issued as directed by Sections 7208 to 7231, 1921 Code. The steps required included a petition of a majority in acreage and number of owners of land in district, a resolution of the commissioners and petition, notice of hearing and judgment of confirmation by the state district court. Such proceeding is in

“rem”. The plan or purpose must be set forth and the Court is given power to determine if the law has been complied with and notice given and likewise determine the validity of the bonds and the levy of the assessments to pay same and from the judgment an appeal is allowed but if not taken or if affirmed the judgment “shall be forever conclusive upon all the world as to the validity of said bonds and said special tax or assessment.” (Section 7211, 1921 Code.)

No appeal was taken. The bonds are negotiable and were designated as 10-30 year serial bonds and were to be paid out of a special assessment “which constitutes a first and prior lien on all the real estate now, or at any time during the life of this bond, included in the said” district. Each bond recited the purpose for which it was issued being the construction of irrigation work and the purchase of a pumping plant and coal lands all as approved by the Public Service Commission of Montana and referred to the resolution of the Board of Directors of the district and the petition of the majority in number and acreage of the holders of title to the lands in the district and the decree of the District Court approving the legality and confirming the validity of all proceedings relative thereto and the levying of a special tax for payment and contained the certificate that all acts, conditions and things required by the constitution and laws of Montana to be done have been done and do exist and that provision has been made for the levy of a special tax upon all the real estate within the district sufficient to meet payment of the bonds.

The bonds were signed by the president and secretary of the district and were registered by the county treasurer and had attached the certificate of the Public Service Commission of Montana that they were legally issued and a public investment, and attached thereto is a copy of the resolution of the board certifying to the agreement that in each and every year all lands within the district would be subject to a levy of a tax or assessment sufficient to discharge the bonds at their maturity and interest. (Bondholders Original Exhibit No. 3 at pages 33 to 37.)

The list of the bondholders (Tr. 41) indicates the bonds were sold to the public, men and women, banks and estates over a wide territory. It is admitted by the county that all of the principal of the bonds remains unpaid. (Brief, page 3.) The bondholders claim, and it is not disputed, (Tr. 36) that the interest on the bonds has not been paid since January 1, 1927. Hence, 100% is due in principal and at least 120% in interest.

Montana has adopted the well established rule that we must construe the irrigation law as a whole.

Drake v. Schoregge, 85 Mont. 94, 277 Pac. 627. That case is also authority for the ruling that in the absence of allegation and proof of fraud, and none is claimed here, the district becomes absolute and if no appeal be taken from the judgment confirming the bonds they may not be questioned thereafter.

There the Court approved the similar ruling of the Circuit Court of Appeals for the Ninth Circuit being

Tomich v. Union Trust Co., 31 Fed. (2d) 515, which involved a Montana district. The plaintiff claimed that his lands were not benefited and it was held that the time to object was at the hearing when the district was formed and that subsequent determination or change of irrigable acreage shall not affect the lien of the bonds. In the *Drake* case under similar attack it was held that the authority to levy the assessments on the lands arose from the fact they were included in the district when formed and when the bonds were issued and were a part of the security pledged by the district for payment of the bonds:

“The security may not be diminished. No change in the boundaries of the district as organized shall impair or effect its organization, nor shall it affect, impair, or discharge any contract, obligation, lien, or charge for which it was liable before such change.”

Changes in the boundaries, extension or exclusion of lands, like the creation of the district require judicial action or due process under the law, but it is expressly provided that any change of the boundaries cannot impair nor affect any contract or lien. Section 7188.

Lien of Bonds.

Section 7213 of the 1921 Code, which is the same as the 1935 Code, expressly provided that all bonds issued

“shall be a lien upon all the lands originally or at any time included in the district * * * and said special tax or assessment, shall constitute a

first and prior lien on the land against which levied, *to the same extent and with like force and effect as taxes levied for state and county purposes.*”

In *Krueger v. Morris*, 110 Mont. 559, 107 Pac. (2d) 142, it was held:

“Hence, at this late date, the bond issues must all be regarded as valid, and we must also treat the bonds as constituting liens upon the entire property of the district, since it is not alleged that any protest was made against the confirmation of the proceedings by the District Court under Section 7211.”

Assessments; County Trustee.

Section 7232 to 7250, 1921 Code, provided “all bonds * * * shall be paid by revenue derived from a special tax or assessment levied as hereinafter provided upon all the lands included in the district” and the law made it the duty of the District Commissioners to provide for the annual levy sufficient to meet the interest and principal and Section 7234 provided that “all lands in each irrigation district * * * shall pay at the same rate for all purposes”. The county treasurer is directed to collect the taxes and is made the custodian of the district funds. Sections 7239, 7240, 1921 Code.

Section 7243 of the 1921 Code provided that when land in the district be sold by the county treasurer for delinquent taxes and the assessments of the district form a part of the taxes for which sold the county treasurer shall place to the credit of the dis-

trict the assessments. And again under Section 7246 the duty was imposed upon the county commissioners to sell lands acquired by tax deeds within three months and pay to the district or the holders of certificates the full amount of taxes and assessments of the district.

The case of *State ex rel. Malott v. Board of County Commissioners*, 89 Mont. 37, 296 Pac. 1, was brought by the bondholders to compel the county to sell the lands in the district under the assumption that the liens of the assessments were equal or prior to the general taxes. The Court refused to so hold but did state in part:

“The bonds are not an obligation of the district at all, but rather a charge against the lands within the district. The lien applies to the lands within the district. The district in its capacity as a public corporation, merely acts as the agency through which the assessments are levied and collected. * * *

“When the county acquires these lands by tax deed on account of delinquent taxes and irrigation district assessments, it takes and holds such title as a trustee. The moneys derived from the sale of such lands are trust funds. The parties and entities interested in that fund are the school districts within the county, the county itself, the state to the extent of the taxes owing to it, the bondholders, and the holders of the debenture certificates. If the lands shall sell for an amount in excess of the taxes and assessments, then, after the payment of the general taxes, applying the well-established rules of equity, the remainder of

the money should be turned over to the irrigation district, provided that sum does not exceed the total amount which would have been assessed against these lands on account of the bonds, had such lands not been transferred by tax deed. Thus the bondholders will have received the full value of all of their security."

Again in *State ex rel. Malott v. Cascade County*, 94 Mont. 394, 22 Pac. (2d) 811, an attempt was made to prefer the debenture certificates, which the Court denied but did say in part:

"Summing up these statutes, it is seen that, upon the issuance of the debenture certificates, the irrigation district, or its vendee, is the owner of an interest in the land, which is never divested until the land is sold. * * * The County has no right, title or interest whatever in the debenture certificate. * * * When the lands are struck off to the county and the debenture certificates are issued *as required by the law* the county occupies the position of a trustee for the interested parties, including, of course, the bondholders."

The Court held that the county merely held the legal title and the irrigation district the equitable interest in the land to the extent of the assessments, and the Court further said:

"The county, as trustee, cannot lawfully do anything adverse to the rights of the bondholders, beneficiaries under the trust. After issuing the debenture certificate it can perform but two acts (or related acts) with respect to the lands: (1) Receive money paid upon redemption and distribute the same; (2) obtain a deed to the lands, sell

the same, and distribute the money received upon the sale.”

In that case it was also held:

“It will be borne in mind that the state and the county, as well as the bondholders or the holders of the debenture certificates, have an interest in the land.”

As argued in this case it was contended that the bondholders’ only interest or right was to redeem the lands from the taxes but the Court in the last cited case held:

“It is argued that the bondholders have the right to redeem the lands prior to the issuance of a deed by the county. Whether this be true or not, it does not furnish an adequate answer to the questions presented. If out of their pockets they provide the money to save the lands which are pledged to pay debts owing to them, they will reach but one end—the annulment of the tax sale. Redemption will not give them any title.”

In 94 Mont. 394, at page 406, the Court affirmed the doctrine that when irrigation district lands are struck off to the county under the statute debenture certificates are issued and the county becomes a trustee, which trust is not discharged until the lands are redeemed or sold and the proceeds distributed “agreeably to equity”.

Section 7243, 1921 Code, in force at the time of the issuance of the bonds and which is the same under the 1935 Code made it mandatory upon the county through its county treasurer, as its agent, to issue

debenture certificates showing interest of irrigation district, as follows:

“the County treasurer of such county *must*, upon the issuance of the tax certificate of tax sale to said county, issue to said irrigation district, and in its corporate name, a debenture certificate for the amount of taxes and assessments due to said irrigation district from said lands and premises so sold, inclusive of the interest and penalty thereon, which certificate shall be evidence of and conclusive of the interest and claim of said irrigation district in, to, against, and upon the lands and premises so struck off to said county at such tax sale, and from and after the issuance of said certificate, the sum named therein and the taxes and assessments of said district evidenced thereby shall bear interest at the rate of one per centum per month from the date of said certificate until redeemed in the manner provided for by law for the redemption of the lands sold for delinquent state and county taxes, or until paid from the proceeds of the sale of the lands and premises described therein, in manner provided”.

The county could only act through the county treasurer and, of necessity, the treasurer was agent for the county, *State ex rel. v. Bailey*, 99 Mont. 484, 44 Pac. (2d) 740. It would have been impossible for the bondholders scattered over the United States to have been at the elbow of the county treasurer and direct him in a ministerial matter wherein his duty was already prescribed by law and hence, the law presumes:

“15. That official duty has been regularly performed.”

and

“33. That the law has been obeyed.”

See Section 10606, Revised Codes of 1935, and
Cavitt v. Seirson, 175 P. (2d) 767.

Of course, the debenture certificates exist for the protection of the bondholders. The legal duty of the county treasurer followed without inquiry into or question of the facts. *State ex rel. Wolff v. Guerkind*, 109 P. (2d) 1094, 133 A. L. R. 304.

The case of *State ex rel. v. Rorabeck*, 111 Mont. 320, 108 Pac. (2d) 601, involved an irrigation district and held the principal and interest of the bonds were payable out of the particular fund in the custody of the county treasurer and that the officers of the district and the county treasurer “stand in the relation of trustees for the bondholders of the district”, and it was there held that all the bonds must be paid pro rata from the special fund.

The property owners, the officers of the district and of the State of Montana issued these bonds and sold them to innocent persons with the express approval of the Court. No contention is made of fraud or lack of authority and the bonds contain recitals that should not be repudiated by the district, the county or even the Federal Court after 27 years. The rule of estoppel in a case of this kind is adopted in Montana:

Edmunds v. City of Glasgow, 89 Mont. 596, 300 Pac. 203, 86 A. L. R. 1052.

The law clearly sustains the bondholders’ liens on all the lands in the district including the Yale Tract

1-27 where the amount due is \$758 and the Scottish American Mortgage Co., Ltd., tract Nos. 1-47 and 1-53 where the amount due was \$425.

It should not be necessary to extend this brief with citations supporting the bondholders' claim that the Court had no jurisdiction to change the boundaries of the irrigation district about 27 years after the establishment thereof to permit the two tracts last described to be excluded therefrom. We submit the judgment is wrong in that respect.

The Montana Legislature recognized the necessity of protecting bonds which were issued for special improvements including irrigation districts and the present law which protected the outstanding bonds in this irrigation district was enacted as Chap. 63, Laws of 1937. The tax deeds to the county were nearly all dated December 11, 1939, (Tr. 97) and hence the lands were subject to said Chapter 63 which reads in part:

“Section 2215.9. Effect of deed. The deed hereafter issued * * * shall convey to the grantee the absolute title to the lands * * * except the lien for taxes * * * and the lien of any special, local improvement, irrigation and drainage assessments levied against the property payable after the execution of said deed.”

The law and the agreement part of the bonds required annual assessments. After Dec. 11, 1939, the lien of the bonds required annual assessments. Such assessments continued or the right thereto existed even after the county had taken tax deeds. The bondholders

should not have been penalized because a public duty was not performed.

Hence, the bondholders should have collected the amount of the special assessments annually sufficient to pay the interest and retire the bonds.

See *Hartman v. Mimmack*, 154 P. (2d) 279.

Condemnation was the only means by which the government could have acquired title to the lands in the irrigation district.

Sale Not Option.

The answer of the county (Tr. 62) states the county commissioners were willing to option the county tax lands to the United States as of September 5, 1940, but in paragraph 1 of the answer the offer of the county is fixed at January 12, 1942 (Tr. 43) and in the appellant's brief, p. 1, the first date is used.

At any rate the law does not provide for an option. Chap. 198, Laws 1939 of Montana, directs public sale of tax lands within 6 months and if not sold the county commissioners may *sell* at not less than 90% of appraised value. No authority was given to the public officers to option such lands.

Chap. 171, Laws 1941, where a royalty in minerals of 6 $\frac{1}{4}$ % was directed. The act requires the application of the proceeds to all tax funds, or to be pro rated.

In *School Dist. No. 12 v. Pondera Co.*, 89 Mont. 342, 297 P. 498, the rule was approved that even interest, penalties and costs must be apportioned among the taxing funds, unless the law provided otherwise.

Section 7243 of Code protects bondholders in irrigation districts. The irrigation district still exists. Its duty to the bondholders, except as modified or eliminated by condemnation, continues.

Validating Laws.

The Montana Legislature has protected the validity of the bonds by means of Section 7231.1 adopted in 1923 against attacks after one year as to the establishment of the district and the validity of the bonds.

Judith Basin Land Co. v. Fergus County, 50 F. (2d) 292;

State v. Board, 86 Mont. 595, 285 Pac. 932, and the last decision contained the following apt statement:

“The sovereignty of the state of Montana for public welfare has authorized the organization of irrigation districts in the state in aid of agricultural development; it has given recognition to them as municipal corporations, clothed them with authority to issue and sell bonds upon the faith and credit of the district for the purpose of obtaining requisite financial assistance, and assured investors in such bonds of their payment through the machinery of the law. Admittedly, the irrigation district has had the use and benefit of the money obtained on sale of the bonds for its purposes, and to now permit the board of county commissioners to frustrate their payment from the lands embraced in the district upon technical grounds, or because of alleged discretion vested in it, would work a manifest fraud and injustice upon innocent parties who have honestly and fairly parted with their money in reliance upon

the faith and credit of the irrigation district and the protection afforded by the laws of the state. Public municipalities should be held to the strictest accountability in payment of their obligations according to law, so as not to reflect discredit upon them or the state.”

The Montana decisions are followed by the Federal Courts, see *Toole County Irrigation District v. Moody*, 125 Fed. (2d) 498.

Any lien against the property condemned must be satisfied out of the deposit, including tax and assessments:

State of Texas v. Moody's Estate, 156 F. (2d) 698;

U. S. v. 150.29 Acres, 135 F. (2d) 878;

U. S. v. 412,715 Acres, 60 F. Supp. 576;

U. S. v. 9.94 Acres, 51 F. Supp. 478.

The local or state law governs as to the rights and status of the parties making claim to the deposit.

Collector v. Ford Motor Co., 158 F. (2d) 354;

Swanson v. U. S., 156 F. (2d) 442.

IV.

JUDGMENT OF DISTRIBUTION.

Refund on Overpayment.

The judgment shows that the advance order of July 11, 1944, by mistake “evident and was easily made” Dawson County was paid or overpaid \$3315.06 on tracts 494-8, 494-11 and 494-13. The Court corrected

same in the judgment and directed judgment against the United States and the county for refund.

The case of *U. S. v. Miller*, 87 L. Ed. 251 (advance) 63 S. Ct. 276, where it was held that the District Court retain jurisdiction and the Federal Government could collect on overpayment and that to hold otherwise would defeat the policy of the law and work injustice, holding:

“The District Court was dealing with money deposited in its chancery to be disbursed under its direction in connection with an action pending before it. The situation is like that in which litigants deposit money as security or to await the outcome of litigation. Notwithstanding the fact that the court released the fund to the respondents, the parties were still before it and it did not lose control of the fund but retained jurisdiction to deal with its retention or repayment as justice might require.”

The judgment should be affirmed in that respect.

The judgment to which the bondholders are entitled includes:

Balance on deposit (allowed)	\$19,034.89
Refund on overpayment (allowed)	3,642.92
(To which should be added interest at 6% per annum from at least July 11, 1944, date of overpayment to counties—Tr. 67)	
Yale Tract No. 1-27 (Court improperly excluded)	758.00
Scottish-American Mortgage Co. tract Nos. 1-47 and 1-53 (improperly excluded)	425.00

Nature of Condemnation.

The County seeks to avoid the irrigation laws of Montana and the rights of the bondholders by claiming that the title taken by the Government under condemnation is not a sale and in some manner wipes out the liens, interests and rights of the bondholders not only to the lands but also to the compensation paid which stands in place of the land. Here again the appellant confuses the theory in regard to the attempted offer or option of the County and the deposit of the Government in condemnation under Section 258a.

We refuse to consider any passing of title other than condemnation.

It is elementary that all property is subject to eminent domain.

29 *C. J. S.* page 852.

Here the allegations in the complaint are admitted by all parties. The government obtains "title to the said lands in fee simple absolute". The right to compensation shall vest in the persons entitled thereto, and distribution is made upon the application of the parties in interest. The statute reads:

"The Court shall have power to make such orders in respect of incumbrances, liens, rents, taxes, assessments, insurance, and other charges, if any, as shall be just and equitable." (40 USCA Sec. 258a.)

The rights under the irrigation law, the liens of the bonds, the trusteeship of the County and the waiver

of priority under Chapter 63 of the Laws of 1937 whereby the land condemned could be made subject to the payment of the bonds both as to principal and interest on future assessments all demonstrate the right of the bondholders to the protection of their liens and rights to assessments levied or to be levied, and hence, the District Court could not have done otherwise than protect the bondholders, and in the language of the Court:

“The registry fund above described appears to be the only fund to which the bondholders may have recourse in this proceeding to apply on the bonded indebtedness of the district. Distribution to the bondholders apparently is required to be made on a pro rata basis. * * * The legal rights to distribution became fixed and are determinable as of the date the money was deposited in the registry of the Court”. (Tr. 101.)

Interest.

The judgment on the refund should have given interest. The bondholders concede interest is not allowed on compensation paid into Court under Section 258a (40 USCA), but here \$3642.92 the excess payments to the counties and withdrawn improperly on July 11, 1944, was not paid into Court and said section expressly provides that just compensation includes interest at the rate of 6% per annum as the value as of the date of taking. The judgment against the United States should include interest. (R. S. Sec. 966, Sec. 811, Judicial Code.)

V.

ATTORNEYS' FEES.

The learned District Judge kindly held that the services of Messrs. O'Neil and Leonard, representing the bondholders have inured to the benefit of all of them but declined to fix or allow them a fee out of the common fund.

We submit such fee is proper.

The equitable rule is that where a lawyer has rendered service for all of a class and made available a fund for all members of the class even though he appeared for one or a few it is proper that his compensation and expense should come from the entire common fund saved or protected for all and before it is distributed.

The Montana rule is outlined in

Hardware Mutual Casualty Co. v. Butler, 116
Mont. 73, 148 Pac. (2d) 563,

“where, as here, one litigant has borne the burden and expense of successful litigation which has created and brought into court a fund in which others share with him, it is only just and equitable that those who share in the benefits should contribute to the payment for the services of the attorney whose labors resulted in the creating or preserving of such common fund. (*Sears v. Inhabitants of Town of Nahant*, 215 Mass. 234, 102 N.E. 491, Ann. Cas. 1914C, 1296)”

and

“When the litigation resulted in a cash settlement, the attorney thereby earned the right to

participate in the fruits of his victory and to be compensated from the very moneys which his successful prosecution of the action made available.”

See *U. S. v. Hudson*, 39 F. Supp. 797.

Each bondholder will share pro rata in the disbursement and it would be unjust for a few to carry on litigation for years under great expense and let others sit back and enjoy a free ride and have all the advantages without bearing any of the burden.

California follows the equity rule. See:

Wilson v. Harold G. Ferguson Corporation, 25 Cal. (2d) 274, 153 P. (2d) 714; and see *Annotations* in 107 A.L.R. 749,

where almost unlimited cases are cited to sustain the equitable rule. And under the heading “Suit by Bondholders” at page 759, it is said to be inequitable to permit bondholders to share in the benefits without contributing to the expense.

In view of the fact that the fees so paid are contingent, we submit 25% is a reasonable fee to allow the attorneys to be first paid out of the common fund to be distributed, and same should have been allowed.

CONCLUSION.

We submit the judgment of the District Court must be affirmed in so far as it,

a. Authorizes distribution to the bondholders of the irrigation district after the appellant county has been paid in full for general taxes; and

b. Authorizes judgment against the United States in favor of the bondholders for \$3642.92 being the excess awards made to the counties for general taxes and paid through mistake. (Tr. 108.)

But the judgment should be reversed and corrected on cross-appeal, as to:

a. The Honorable District Court should not have attempted to change the boundaries of the irrigation district and excluded therefrom the Yale Tract No. 1-27 and thus deprive the bondholders of their lien thereon and the compensation paid to the extent of \$758 and likewise the Court should not have attempted to change the boundaries of the irrigation district and exclude therefrom the Scottish-American Mortgage Co., Ltd., Tract Nos. 1-47 and 1-53 and deprive the bondholders of their lien thereon and the compensation paid to extent of \$425.

b. Reasonable attorneys' fees should be awarded D. J. O'Neil and P. F. Leonard against the common fund preserved.

c. Interest at 6% per annum from July 11, 1944, should be allowed on the moneys paid in excess being \$3,642.92.

Respectfully submitted,

D. J. O'NEIL,

P. F. LEONARD,

*Attorneys for Appellees
(Bondholders).*

No. 11821

United States
Circuit Court of Appeals
for the Ninth Circuit

DAWSON COUNTY, MONTANA,

Appellant,

vs.

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS,
on their own behalf and on behalf of all bondholders
of the Upper Glendive-Fallon Irrigation District of
the State of Montana, and UNITED STATES OF
AMERICA,

Appellees,

and

MARY HAGAN, E. B. CLARK and MINNIE R. EVANS,
on their own behalf and on behalf of all bondholders
of the Upper Glendive-Fallon Irrigation District of
the State of Montana,

Appellants,

vs.

EDNA YALE, ALLEN W. YALE and RUBY YALE,
his wife, and RUTH PETTERSON and HANS
PETTERSON, her husband, THE SCOTTISH
AMERICAN MORTGAGE COMPANY, LIMITED,
UNITED STATES OF AMERICA, DAWSON
COUNTY and PRAIRIE COUNTY,

Appellees.

Appellant's Reply Brief

Upon Appeals from the District Court of the United States
for the District of Montana

No. 11821

United States
Circuit Court of Appeals
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DAWSON COUNTY, MONTANA,

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MARY HAGAN, E. B. CLARK and MINNIE R. EVANS,
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UNITED STATES OF AMERICA, DAWSON
COUNTY and PRAIRIE COUNTY,

Appellees.

Appellant's Reply Brief

Upon Appeals from the District Court of the United States
for the District of Montana

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OPTION BY COUNTY WAS A CONTRACT OF PURCHASE:

We agree with the appellees that the option contract of the county was a sale. (Tr. p. 24) Prior to the first option contract between the County and the U. S. the county had offered all of the lands involved at public sale pursuant to Montana Law and no bidders appeared and no sale was had. (Tr. pp. 52 to 58) all shown as a part of the Answer of Dawson County. Thereafter on September 5, 1940 an agent of the Farm Security Administration an agency of the United States prepared and presented to the county a resolution whereby the county would sell all of the acreage involved herein for a lump sum agreed upon. (Tr. pp. 59 to 63) A year later a renewal of the option was made but a Stipulation was then entered into between the parties whereby the price was fixed for all purposes (Tr. pp. 95 - 96) this to insure no change in the situation as the United States had taken possession on the first option and removed all buildings, fences and other obstructions to its use of the lands. Abstracts were procured by the county at its expense and furnished to the United States under the conditions of the option contract.

Thereafter the County was under the terms of its contract of sale estopped from taking any further action under the terms of the stipulation as the government had taken over the lands at a fixed price and no action in the

condemnation action to be brought by the government was possible. The said action (the present one herein) was taken as the attorneys for the government admit for the purpose of quieting title to the lands involved. There was no attempt on the part of the government attorneys to set aside, abrogate or invalidate the previous contracts made to purchase the lands. This same situation has been before the Supreme Court of Montana involving the same option contracts in the case of the sale of lands by an individual to the U. S. In that case Calvin v. Custer County (111 Montana 162-107 Pac (2nd) 134) in which all of the points in controversy here as to the option contract and its validity were ruled upon.

We quote from page 166:

“It should first be noted that while the writing in question here was called an ‘exclusive and irrevocable option and right to purchase’ yet it is clear from its terms as a whole that after its acceptance by the United States it became a contract of sale and purchase.” ****

Since in this case as we have already pointed out the United States took possession and had a stipulation made at the same time fixing the price for all purposes and with knowledge that the lands would be the subject of an action for condemnation to clear the title, it is now beyond dispute that the government was the equitable owner of the lands and that the doctrine of equitable conversion prevails here and as stated in the case *supra*; at page 167, we quote:

"In Kern v. Robertson 92 Montana 283, 12 Pac. (2) 565; The authorities are in accord that an enforceable contract for the purchase and sale of real property passes to the purchaser the equitable and beneficial ownership thereof, leaving only the naked legal title in the seller, as trustee for the purchaser and as security for the unpaid purchase price."

The rule is stated in 13 C. J. 855 as follows:

"A contract for the sale of land works a conversion, equity treating the vendor as holding the land in trust for the purchaser, and the purchaser as trustee of the purchase price for the vendor. The vendor's interest thereafter in equity is in the unpaid purchase price, and is treated as personalty, while the purchaser's interest is in the land and is treated as realty." To the same effect is 18 C. J. S. Conversion, Section 9, page 48, and 19 Am. Jur. Equitable conversion section 11. ****

In section 1161 Pomeroy's Equity Jurisprudence 4th Ed. it is said:

"The fact that the contract of purchase is entirely at the option of the purchaser does not prevent its working a conversion, if he avails himself of the option."

And in section 1163, the same author states:

"In contracts of sale with the purchaser's option, the question whether or not a conversion is effected at all cannot of course be determined until the purchaser exercises his option; but the moment when he does exercise it, the conversion, as between the parties claiming title under the vendor, relates back to the time of the execution of the contract."

Here the option was exercised by the taking of possession by the United States and fixing of the full value to be paid by the Stipulation (Tr. pp. 95 - 96) which for all purposes agreed upon was the price to be paid. The sale was fully consummated. The conversion relates back to that date.

ASSESSMENTS: TRUSTEE DOCTRINE

Appellees' brief (pp. 17 to 24) dealing with the assessments for irrigation purposes confuses the instant case with other cases based upon different facts and statutes not applicable to the present case, here there were never any irrigation assessments paid, no irrigation, no works constructed and the sale of the lands for taxes and assessments was made under different statutes.

Much is said about the "debenture certificates" to be issued under certain provisions of Montana law, but here there never were any such issued, hence no vested interest in the lands all of which were subject to general taxes, none of which were paid so that in due time the taxing authorities were obliged to take tax deeds. The bondholders abandoned their security by not paying the taxes in some of the many ways open to them under Montana law. No attempt was made by any of the bondholders to organize and protect their rights for the simple reason that the lands unirrigated were not worth the general taxes. There was no trusteeship on the part of the county as the county did not at any time

have any funds collected from the landowners belonging to the irrigation district. The small sum in the County Treasurer's possession was derived from assessments made in the beginning for the general expense of the district and has remained there subject to warrants for engineering and other costs in the operation of the district. No authorities are cited in support of the trustee doctrine and there are none known to either of the parties to this action, the doctrine of the Malott case (89 Mont. 37 296 Pac. 1) did not have any issue before the court to decide on this phase of the law.

EFFECT OF TAX DEEDS:

The passage of Chapter 63 of the Laws of 1937, did not affect the irrigation districts and bonds issued by them prior to the enactment of this amendment. The act was not retroactive but prospective (State ex rel City of Billings v. Osten, 91 Montana 76, 5 Pac. (2) 562.) In this case the bonds were issued in 1923 and the district created in 1920, so that the laws in effect at that time applied to the lien of the bonds and the enactment of the 1937 act was not applicable to either the district or its bonds. The law in regard to this phase of the matter is well reviewed in the Montana case of Cascade County v. Weaver et al; 108 Mont. 1 90 Pac. (2) 164. From this case it appears that only those districts created after the passage of the act may look to its "exceptions" for their benefit.

CONCLUSION

We conclude by pointing out that at no time after the creation of the District was there any funds in the County Treasurer's hands for the payment of the bonds or interest on them, no land owner paid any of the assessments made lawfully by the Commissioners of the district which ceased to function in 1927. The law does not require an officer to perform an idle or useless act. The bondholders could not collect that which did not exist. There were no funds. They failed to protect their lien under Montana law and it was effectually and absolutely wiped out by the tax deeds. The County obtained a new title and as the owner of the lands sold to the United States for a fixed consideration agreed upon by both parties is now entitled to the funds remaining which are the value of the lands taken both under the contracts made and the condemnation awards made in pursuance of these agreements.

Respectfully submitted:

D. C. WARREN

E. W. POPHAM

Attorneys for Appellant.

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

DAWSON COUNTY, MONTANA, APPELLANT

v.

**MARY HAGEN, E. B. CLARK, AND MINNIE R. EVANS, ON THEIR
OWN BEHALF AND ON BEHALF OF ALL BONDHOLDERS OF THE
UPPER GLENDIVE-FALLON IRRIGATION DISTRICT OF THE STATE
OF MONTANA, AND UNITED STATES OF AMERICA, APPELLEES**

and

**MARY HAGEN, E. B. CLARK, AND MINNIE R. EVANS, ON THEIR
OWN BEHALF AND ON BEHALF OF ALL BONDHOLDERS OF THE
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v.

**EDNA YALE, ALLEN W. YALE, AND RUBY YALE, HIS WIFE, AND
RUTH PETTERSON AND HANS PETTERSON, HER HUSBAND, THE
SCOTTISH AMERICAN MORTGAGE COMPANY, LIMITED, UNITED
STATES OF AMERICA, DAWSON COUNTY AND PRAIRIE COUNTY,
APPELLEES**

**UPON APPEALS FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE DISTRICT OF MONTANA**

BRIEF FOR THE UNITED STATES

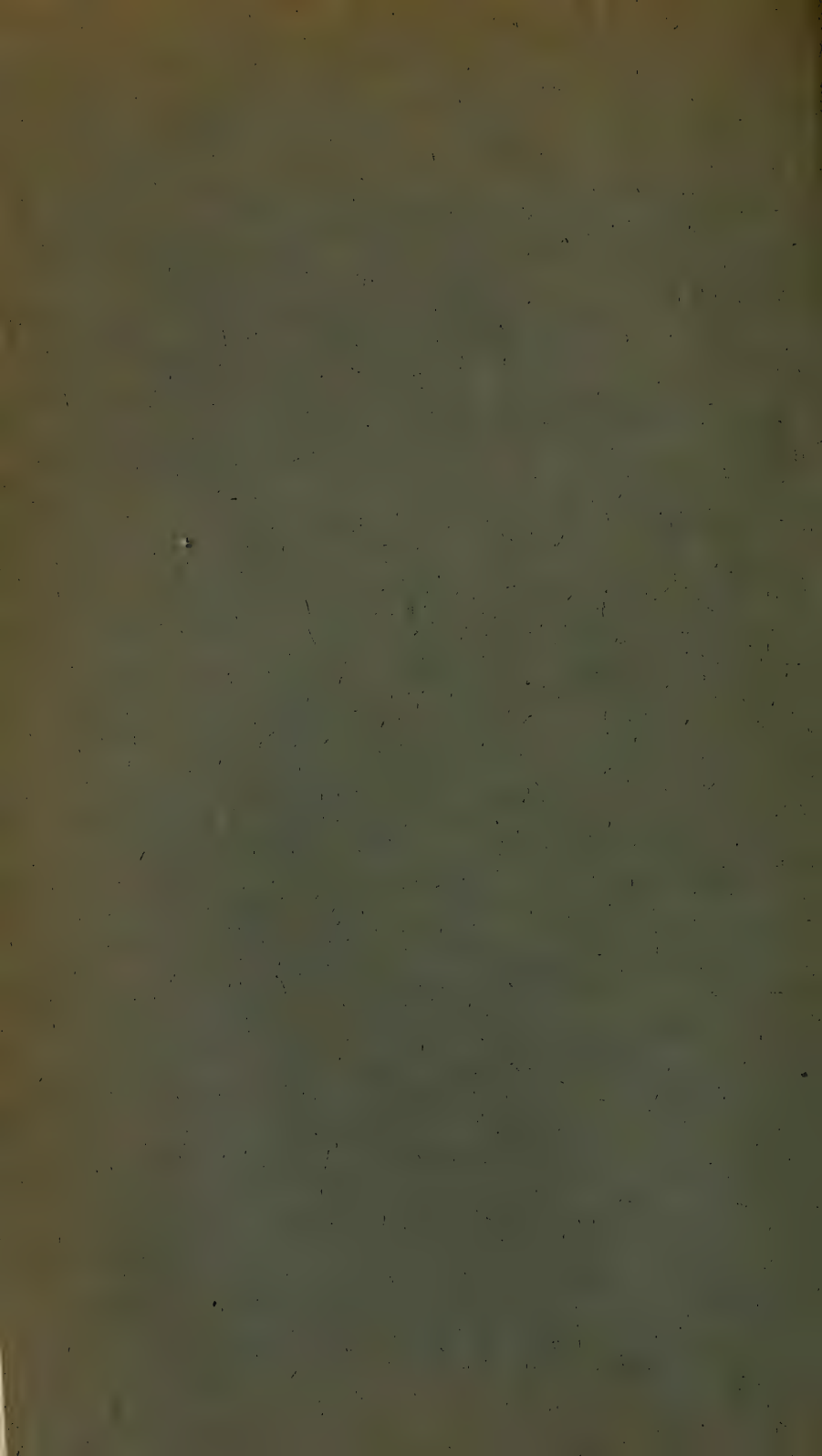
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MAY 12 1940

PAUL E. POWERS



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In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11,821

DAWSON COUNTY, MONTANA, APPELLANT

v.

MARY HAGEN, E. B. CLARK, AND MINNIE R. EVANS, ON
THEIR OWN BEHALF AND ON BEHALF OF ALL BOND-
HOLDERS OF THE UPPER GLENDIVE-FALLON IRRIGATION
DISTRICT OF THE STATE OF MONTANA, AND UNITED
STATES OF AMERICA, APPELLEES

and

MARY HAGEN, E. B. CLARK, AND MINNIE R. EVANS, ON
THEIR OWN BEHALF AND ON BEHALF OF ALL BOND-
HOLDERS OF THE UPPER GLENDIVE-FALLON IRRIGATION
DISTRICT OF THE STATE OF MONTANA, APPELLANTS

v.

EDNA YALE, ALLEN W. YALE, AND RUBY YALE, HIS
WIFE, AND RUTH PETTERSON AND HANS PETTERSON,
HER HUSBAND, THE SCOTTISH AMERICAN MORTGAGE
COMPANY, LIMITED, UNITED STATES OF AMERICA,
DAWSON COUNTY AND PRAIRIE COUNTY, APPELLEES

*UPON APPEALS FROM THE DISTRICT COURT OF THE UNITED
STATES FOR THE DISTRICT OF MONTANA*

BRIEF FOR THE UNITED STATES

OPINION BELOW

The views of the district court are stated in its
Decision and Order (R. 98-109), which has not been
reported.

JURISDICTION

These are appeals by adverse claimants to a condemnation award, taken from a judgment entered September 4, 1947 (R. 98-109), on petitions for distribution. Notice of appeal was filed by appellant Dawson County on October 25, 1947 (R. 110-111); notice of cross-appeal was filed by appellants Hagen, et al., on December 4, 1947 (R. 115-117). Jurisdiction of the district court was invoked under the General Condemnation Act of August 1, 1888, 25 Stat. 357, 40 U. S. C. sec. 257, and the Act of October 14, 1940, 54 Stat. 1119. The jurisdiction of this Court rests on section 128 of the Judicial Code, as amended, 28 U. S. C. sec. 225 (a).

QUESTION PRESENTED

So far as concerns this appellee, the only question presented is whether a void judgment against the United States should be modified to include interest.

STATEMENT

This is a proceeding brought by the United States under the Act of October 14, 1940, 54 Stat. 1119, 16 U. S. C. secs. 590y-590z-11 (R. 3), to condemn 5,788.21 acres of land in Dawson and Prairie Counties, Montana (R. 4-11). On March 27, 1944, the United States filed its amended complaint (R. 2-28) and declaration of taking, and deposited in court \$32,389.00 as estimated just compensation (cf. R. 89-90). On May 13, 1944, appellants Hagen et al. filed an answer claiming a lien on the property as bondholders of the Upper Glendive-Fallon Irrigation District (R.

28-42). On May 20, 1944, appellant Dawson County filed an answer and petition for distribution (R. 43-64) and reply to the answer and claim of the bondholders (R. 65-66), asserting tax title to the lands lying in Dawson County and asking distribution of \$23,526.00 deposited in court as estimated just compensation for those lands.¹ On July 11, 1944, the trial court entered an order distributing \$10,628.57 to Dawson County (R. 67-68). Commissioners were appointed and on October 1, 1945, they filed their report (R. 69-77), appraising the property, by tracts, at valuations totaling \$32,389.00, of which \$23,526.00 was for lands in Dawson County. No objection being made thereto, the court on December 5, 1945, entered its "Final Judgment in Condemnation" fixing the value of the property accordingly and declaring title to be vested in the United States (R. 78-90).

On June 25, 1946, Dawson County filed its petition for distribution of \$12,897.43, the balance remaining in court attributable to lands claimed by the county (R. 91-93). On October 21, 1946, the bondholders filed a petition for distribution of \$22,677.81 and for an order requiring Dawson and Prairie Counties to refund to the court \$3,315.06 and \$327.86, respectively, by which amounts the distributions already made to them were alleged to have exceeded their proper claims (R. 94-95). On September 4, 1947, the court entered its "Decision and Order" (R. 98-109) holding

¹ It was stipulated between Dawson County and the United States that the total value of the lands in Dawson County was \$23,526.00 (R. 95-96). The county had previously given the United States an option to buy the lands at that price (R. 59-64).

that overpayments had been made to the counties as alleged and that the bondholders were entitled to payment thereof, and concluding (R. 109) :

Accordingly it is ordered and this does order that the Counties, Dawson and Prairie, return forthwith to the registry of the court the respective amounts above set forth as overpayments, and in default thereof, the proper authorities of the Government will be so advised, in order that proceedings may be commenced for the recovery of such overpayments; and in the meantime, under Section 258a judgment for the additional sum of \$3,642.92, representing the overpayments, will be ordered, and is hereby ordered, entered against the United States, and distribution of the funds in the registry of the court will be made according to the foregoing decision. Exceptions are allowed counsel.

Notice of appeal was filed by Dawson County on October 25, 1947 (R. 110-111). On December 4, 1947, the bondholders filed their notice of cross-appeal (R. 115-117) and statement of points on cross-appeal (R. 118-119). In addition to conflicting claims of the counties and bondholders raised by the appeal and cross-appeal, the cross-appeal presents the contention by the bondholders that the United States should have been required to pay interest on the amounts overpaid to the counties (R. 119). That is the only point on either appeal that directly concerns the United States.

SUMMARY OF ARGUMENT

The final judgment in condemnation fixed just compensation at \$32,389.00. That determined the

liability of the United States. Having paid that sum into court, the United States was not further concerned with the proceedings. The court was without jurisdiction to enter a further judgment against the United States, 21 months later, on proceedings for distribution. The purported judgment so entered against it was therefore void. An allowance of interest thereon would be likewise void, and so should not be ordered by this Court.

ARGUMENT

The judgment against the United States is void ²

A judgment in condemnation, fixing just compensation for the property condemned, is a final judgment. After it is entered, the court retains jurisdiction only to make distribution of the award to the persons entitled thereto. *United States v. 111,000 Acres of Land in Polk and Highlands Counties*, 155 F. 2d 683 (C. C. A. 5, 1946). When the United States deposited in court the amount awarded (R. 90), it discharged its entire liability; it was not concerned with the proceedings for distribution and would not have been a proper party thereto. *United States v. Dunnington*, 146 U. S. 338, 352 (1892). The court had no jurisdiction, in distribution proceedings, to enter further judgment against the United States. See *United States v. 111,000 Acres of Land in Polk and Highlands Counties*, 155 F. 2d 683 (C. C. A. 5, 1946).

² Since the judgment is void, it does not affect the rights or liabilities of the United States, and proceedings to vacate it may be instituted at any time. *United States v. Turner*, 47 F. 2d 86, 88-89 (C. C. A. 8, 1931).

If the judgment of September 4, 1947 (R. 98-109), here appealed from, were to be regarded as a modification of the determination of just compensation made by the Final Judgment of December 5, 1945 (R. 78-90), it was beyond the jurisdiction of the court because not made during the same term of court or on a motion made during that term.³ *E. C. Shevlin Co. v. United States*, 146 F. 2d 613, 616 (C. C. A. 9, 1944); *United States v. 534.7 Acres of Land in Orange County*, 157 F. 2d 828, 831 (C. C. A. 5, 1946).

The judgment appealed from does not purport to be a modification of the former determination of just compensation; in fact, it is premised on the proposition that that determination was correct. Under that view, it is equally void. Consent alone gives jurisdiction to adjudge against the United States. *United States v. United States Fidelity Co.*, 309 U. S. 506, 514 (1940). By filing a declaration of taking, the United States consented to entry of judgment against itself for whatever might be found to be just compensation for the property taken. 40 U. S. C. sec. 258a. See *Catlin v. United States*, 324 U. S. 229, 241-242 (1945). It did not consent to entry of any different or greater judgment. Since the judgment of December 5, 1945, fixed just compensation for the property, and the amount so fixed was paid into court by the United States, the further judgment of September 4, 1947, was necessarily for a sum additional

³ Terms of court at Billings, where this case was tried (R. 2), begin on June 1 and December 15 of each year. Rules of the United States District Court for the District of Montana.

to just compensation. Such a judgment was beyond the jurisdiction of the court to enter. *United States v. 534.7 Acres of Land in Orange County*, 157 F. 2d 828, 831 (C. C. A. 5, 1946); *United States v. Merchants Transfer & Storage Co.*, 144 F. 2d 324, 327 (C. C. A. 9, 1944).

II

The judgment against the United States should not be modified to include interest

The judgment against the United States being void, an award of interest would be void for the same reasons. In any event, the United States is not liable for interest except as expressly provided by contract or statute, or as part of just compensation. *Boston Sand Co. v. United States*, 278 U. S. 41, 47 (1928). No contract or statute supports appellants' claim for interest here, and, as already pointed out, this award cannot be considered one for just compensation, because the full just compensation adjudged was deposited in court by the United States on the date of taking.⁴ Since the award of interest would be a nullity, just as the judgment appealed from is a nullity, this Court should not direct its allowance.

⁴ There is no merit to the suggestion of appellee bondholders (Br. 29) that the \$3,642.92 was not "deposited in court" within the meaning of 40 U. S. C. sec. 258a because the deposit was disbursed by the court to the wrong parties. The duty to make distribution is on the court. A mistake by it can be corrected by appeal; it does not give any further right against the United States. *United States v. Certain Parcels of Land in Prince Georges County*, 40 F. Supp. 436, 443 (Md. 1941).

CONCLUSION

For the foregoing reasons, the judgment against the United States should not be modified to include interest.

Respectfully,

A. DEVITT VANECH,
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MAY 1948.

No.11822

United States
Circuit Court of Appeals
For the Ninth Circuit.

EMANUEL STAVROS HOUVARDAS,
Appellant,

vs.

I. F. WIXON, District Director of Immigration
and Naturalization,
Appellee.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Northern District of California,
Southern Division

FILED
MAR -4 1948

PAUL P. O'BRIEN,

No.11822

United States
Circuit Court of Appeals
For the Ninth Circuit.

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Southern Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the Southern Division of the United States
District Court, in and for the Northern District
of California

No. 27406-R

In the Matter of

EMANUEL STAVROS HOUVARDAS,

On Habeas Corpus

(San Francisco Immigration File No. 12020/32327)

PETITION FOR WRIT OF HABEAS CORPUS

To the Honorable, the Southern Division of the
United States District Court, for the Northern
District of California:

The petition of Emanuel Stavros Houvardas respectfully shows:

I.

That the petitioner is a native of Greece, having arrived in the United States of America at the age of eighteen years on the Steamship "King Albert" in the month of March or April, 1912, at the Port of New York, N. Y., and was duly admitted at said time for permanent residence in the United States by the United States Immigration authorities at said Port;

II.

That immediately after the said arrival and clearance by said Immigration authorities, as aforesaid, your petitioner proceeded to the State of Cali-

ifornia and ever since the month [1*] of March or April, 1912, has resided continuously in the State of California, and has resided continuously within the United States for thirty-five years last past, from said time of entry up to and including the present date;

III.

That your petitioner is now unlawfully in the custody of I. F. Wixon, District Director of Immigration and Naturalization, for the District of San Francisco, at No. 630 Sansome Street, San Francisco, California, under and pursuant to an Order of Deportation issued March 18, 1946, whereby your petitioner is ordered deported to the Island of Samos, Greece; that your petitioner is informed and believes, and therefore avers the fact to be, that said Order charges that your petitioner is subject to deportation under the Act of February 5, 1917, in that he was after May 1, 1917, sentenced to a term of imprisonment more than once for a term of one year or more for the commission, subsequent to his entry, of crimes involving moral turpitude;

IV.

That on or about the 27th day of January, 1939, in the Superior Court of the State of California, in and for the County of Los Angeles, in proceedings numbered 74489, your petitioner was found guilty as charged in each of two counts of the information filed against him and his application for probation and the pronouncing of judgment and sentence were

*Page numbering appearing at foot of page of original certified Transcript of Record.

set for February 14, 1939. That on said last mentioned date the Court in said matter pronounced judgment against your petitioner as follows:

“No legal cause appearing why judgment should not be pronounced, the Court pronounces judgment and sentence as to Counts 1 and 2 of the information as follows: Defendant is sentenced to the California State Prison at San Quentin on each of said counts for the term prescribed by law. These sentences are entered in Judgment Book No. 39, Page 397, and are ordered [2] to run Concurrently.

Execution of sentences is suspended and defendant is placed on probation for a period of five years under the following conditions: Defendant must serve the first ten months of his probationary period in the County Jail. Defendant must pay a fine of \$200 and must obey all laws.”

V.

That thereafter and on or about the 14th day of April, 1942, in the Superior Court of the State of California, in and for the County of Fresno, in proceedings numbered 10714 your petitioner, after the entry of his plea of guilty as charged in an information theretofore filed against him was by said Court punished by imprisonment in the State Prison of the State of California at San Quentin until legally discharged;

VI.

That thereafter and on or about the 28th day of April, 1942, the said Superior Court in and for the County of Los Angeles, in said proceedings numbered 74489, made and entered the following order, to-wit:

“Probation having been heretofore revoked, the sentences imposed on February 14, 1939, committing this defendant to the California State Prison at San Quentin for the term prescribed by law as to each of Counts 1 and 2, Concurrently, are placed into full force and effect. These sentences are ordered to run Concurrently with State Prison sentence pronounced in Fresno County, which defendant is now serving.”

VII.

That thereafter your petitioner was received by the Warden of the said State Prison at San Quentin, California, in execution of the sentence imposed upon him by the Superior Court of the State of California, in and for the County of Fresno, as aforesaid, and by virtue of the said order of the Superior Court of the State of California, in and for the County of Los Angeles, revoking said Order of Probation; the said [3] sentences from the said Superior Court of Los Angeles County to run concurrently with said prison sentence pronounced in the said Superior Court of Fresno County under which commitment the defendant was received by the said Warden as aforesaid at said prison on April 15, 1942;

VIII.

That thereafter at a meeting of the State Board of Prison Terms and Paroles, California State Prison, San Quentin, California, the said Board on March 22, 1944, made and entered the following order:

“Whereas, said prisoner was heretofore sentenced to be confined in the State Prison of the State of California, and was received by the Warden of the State Prison at San Quentin, California, in execution of his sentence, on the 15th day of April, 1942; and

“Whereas, said prisoner has served that portion of his time as is required, and the Board of Prison Terms and Paroles (the Board that has been given the authority so to do) has duly examined and considered all of the particulars of his case;

“Now Therefore, It Is Hereby Resolved and Determined by the Board of Prison Terms and Paroles that the said person (prisoner) shall be confined in the State Prison 10 yrs. & 10 Yrs. & 10 Yrs. CC. from and after the date on which he was received by said Warden as aforesaid, provided that there shall be deducted from said length of time of confinement the aggregate of all time credits provided for by law which the prisoner shall have earned and been allowed and not forfeited.

“Further Resolved, that in case any convicted person undergoing sentence in any of

the state prisons commits any infractions of the rules and regulations of the prison board, or escapes while working outside such prison under the surveillance of prison guards, the Board may revoke any order theretofore made determining the length of time such a convicted person shall be imprisoned, and make a new order determining such length of time not exceeding the maximum penalty provided by law for the offense for which he was convicted, unless the sentence be sooner terminated by commutation or pardon by the governor of the state.

“Further Resolved, that the said prisoner shall be allowed to go upon parole, according to the law governing parole, for and during: when served half time on Fresno Co. Commitment unless the Board shall hereafter otherwise determine.

“Attest:

----- ,
Secretary,

WARD J. ESTELLE,
Asst. Secretary.” [4]

IX.

That thereafter and on the 23rd day of January, 1945, your petitioner was released from said State Prison at San Quentin on parole, for the crimes under which he is undergoing sentence, for a period of three calendar years, which said parole shall expire on January 23, 1948;

X.

That pursuant to the laws of the United States respecting the deportation of aliens convicted of crimes involving moral turpitude, it is provided that no alien convicted as aforesaid shall be deported until after the termination of his imprisonment. That the imprisonment of your petitioner has not as yet terminated because your petitioner is still on parole from said State Prison and is under the authority, supervision and direction of the Parole Officer of the State of California, and has been and is now currently subject to all of the rules and regulations of said Parole Officer; and your petitioner's imprisonment will not be terminated until the completion of his term of parole on January 23, 1948;

XI.

That pursuant to the laws of the United States respecting the deportation of aliens convicted of crimes involving moral turpitude, it is provided that said laws shall not apply to those persons who have been pardoned for their crimes; that, in this connection, heretofore and on or about the 12th day of September, 1946, your petitioner, acting through his then attorney, sought to make application for a pardon to Honorable Earl Warren, Governor of the State of California; that your petitioner is informed and believes, and therefore avers the fact to be, that the said Governor would refuse to receive, entertain or act upon any application for said pardon unless the same be in conformity [5] with

the Procedure for Restoration of Rights and Application for Pardons as set forth in the provisions of Sections 4852.01 to 4852.2, inclusive, of the Penal Code of the State of California; that your petitioner does not at this time come within the provisions of Section 4852.06 of the said Penal Code which provides, among other things, as follows:

“No such petition shall be filed until and unless the petitioner has continuously resided, after leaving prison, in the county in which it is filed for a period of not less than three years immediately preceding date of filing the petition . . .”;

in this connection, your petitioner alleges that upon his release from said San Quentin Prison on January 23, 1945, he became and ever since has been a resident of the County of Marin, State of California, and since his release from said prison has lived an honest and upright life, and has conducted himself soberly and industriously and morally and has in all respects obeyed the laws of the land;

XII.

That the rights of your petitioner herein, to-wit, the right to apply for a pardon, have not been exhausted and are still open and available to him but your petitioner by reason of said detention and threatened deportation is being denied the right to apply for said pardon; that your petitioner therefore is powerless at this time to assert his rights in the matter of applying for said pardon and may

not legally assert the same until on or after January 23, 1948 when he shall then have been a continuous resident of the County of Marin, State of California, for at least three years from the time of his release from said State Prison;

XIII.

That your petitioner is informed and believes and therefore avers the fact to be that he is to be removed from [6] the jurisdiction of the above entitled Court by said District Director on the 11th day of July, 1947, for removal to some unknown port of embarkation on the east coast of the United States, there to be placed aboard a vessel for deportation to Greece unless otherwise restrained by this Honorable Court;

XIV.

That the hearing and proceedings had in the matter of the deportation of your petitioner and the action of the Immigration and Naturalization authorities and said District Director thereof ordering your petitioner to be deported, as aforesaid, were and are in excess of the powers and jurisdiction conferred upon them and are in excess of the authority committed to them by the Statutes and Constitution of the United States in such cases made and provided;

XV.

That your petitioner has not in his possession the file of the proceedings before the said District Director or the Commissioner of Immigration at

Philadelphia, Pennsylvania; that the original immigration records, including the findings and decision in the matter are on file with the said District Director, by reason of which the records are not now available to your petitioner; that your petitioner stipulates that as soon as said records are made available the same may be filed in and made a part of the proceedings herein;

XVI.

That it is the intention and purpose of the said District Director to deport your petitioner at once, and unless this Honorable Court intervenes to prevent said deportation your petitioner will be unlawfully deprived of his residence within the United States of America;

Wherefore, your petitioner prays that a Writ of Habeas Corpus issue as prayed for directed to the District Director of Immigration and Naturalization directing him to hold the body of your petitioner within the jurisdiction of this Court and to present the body of your petitioner before this Court at a time and place specified in the order, together with the time and cause, if any he has, of his detention so that the same may be inquired into to the end that your petitioner may be restored to his liberty and go hence without delay; and that the Court release the said petitioner during this proceeding upon such bail as this Honorable Court shall deem meet and proper. Your petitioner here-

tofore has been permitted his liberty by the United States Immigration Authorities on bail of \$500.00.

Dated this 10th day of July, 1947.

FREITAS, DUFFY &
KEATING,
By JEROME A. DUFFY,
Attorneys for Petitioner.

United States of America,
State of California,
City and County of San Francisco—ss.

Emanuel Stavros Houvardas, being first duly sworn, deposes and says:

That he is the petitioner named in the foregoing Petition for Writ of Habeas Corpus; that he has read the same and knows the contents thereof, and that the same is true of his own knowledge except as to those matters which are therein stated on information and belief, and as to those matters that he believes it to be true.

/s/ EMANUEL STAVROS
HOUVARDAS.

Subscribed and sworn to before me this 10th day of July, 1947.

[Seal] J. ELEANOR JONES,
Notary Public in and for said City, County and State.

[Endorsed]: Filed July 10, 1947. [8]

[Title of District Court and Cause.]

ORDER TO SHOW CAUSE

Good Cause Appearing Therefore and upon reading the verified petition on file herein,

It Is Hereby Ordered that I. F. Wixon, District Director of Immigration and Naturalization for the District of San Francisco, appear before the above entitled Court on the 21st day of July, 1947, at the hour of 10:00 o'clock a.m. of said day, to show cause, if any he has, why a Writ of Habeas Corpus should not be issued as prayed for, and that a copy of this Order be served upon the said District Director of Immigration and Naturalization, and that a copy of the Petition and said Order be served upon the United States Attorney for his District, his representative herein.

And It Is Further Ordered that Emanuel Stavros Houvardas, the petitioner herein, be not removed from the [9] jurisdiction of this Court and that he be enlarged on bond in the sum of \$1000.00 pending this hearing and until further orders herein.

Dated this 10th day of July, 1947.

MICHAEL J. ROCHE,

United States District Judge.

Bond in amount of \$1000 consented to.

FRANK J. HENNESSY.

By JAMES T. DAVIS,

Asst. U. S. Atty.

[Endorsed]: Filed July 10, 1947. [10]

[Title of District Court and Cause.]

RETURN TO ORDER TO SHOW CAUSE

Comes now I. F. Wixon, as District Director, United States Immigration and Naturalization Service, Port of San Francisco, and for cause why a writ of habeas corpus should not issue herein, shows:

I.

That the person in whose behalf the petition for writ of habeas corpus was filed, who is also known as Emanuel Stavros Houvardas, is detained by respondent, I. F. Wixon, as District Director of United States Immigration and Naturalization Service, Port of San Francisco, California, under and by virtue of a warrant of deportation duly and regularly issued on the 18th day of March, 1946, by the Attorney General of the United States after a hearing duly and regularly held before an Immigrant Inspector of the United States.

II.

That a true copy of said warrant of deportation and the original record of the entire proceedings pertaining thereto are annexed hereto and made a part hereof as Respondent's Exhibit "A."

Wherefore, Respondent prays that the petition for writ of habeas corpus herein be denied.

/s/ F. F. WIXON,

District Director, Immigration and Naturalization Service, Port of San Francisco, California.

[Endorsed]: Filed Aug. 15, 1947. [11]

[Title of District Court and Cause.]

ORDER GRANTING MOTION TO SET ASIDE
SUBMISSION, DISCHARGING ORDER
TO SHOW CAUSE, TERMINATING RE-
STRAINING ORDER, AND DENYING
PETITION FOR WRIT OF HABEAS
CORPUS

The Motion of the Petitioner to set aside the submission of the above entitled matter to permit the introduction of evidence not before the Board of Immigration Appeals of the Department of Justice at the time of the making of its Findings of Fact and Conclusions of Law, is granted.

The restraining order issued by this Court on July 10, 1947, is hereby terminated and the Order to Show Cause issued by this Court on the same date is discharged.

The Petition for a writ of habeas corpus is denied.

Dated this 4th day of November, 1947.

MICHAEL J. ROCHE,
United States District Judge.

[Endorsed]: Filed Nov. 4, 1947. [12]

[Title of District Court and Cause.]

NOTICE OF APPEAL

To the Clerk of the Above Entitled Court, to I. F. Wixon, District Director of Immigration and Naturalization, and Frank J. Hennessy, Esq., United States Attorney, His Attorney:

You and Each of You Will Please Take Notice that Emanuel Stravros Houvardas, the petitioner in the above entitled matter, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the order and judgment rendered, made and entered on November 4, 1947, denying the Petition for Writ of Habeas Corpus filed herein.

Dated November 4, 1947.

FREITAS, DUFFY &
KEATING,

By JEROME A. DUFFY,
Attorneys for Petitioner.

[Acknowledgement of receipt of service.]

[Endorsed]: Filed Nov. 4, 1947. [13]

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO DOCKET

Good cause appearing therefor, it is hereby Ordered that the Appellant herein may have to and including January 23, 1948, to file the Record on Appeal in the United States Circuit Court of Appeals in and for the Ninth Circuit.

Dated December 11, 1947.

MICHAEL J. ROCHE,
United States District Judge.

[Endorsed]: Filed Dec. 11, 1947. [14]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON APPEAL

To the Clerk of the United States District Court
above named:

You are respectfully requested to prepare and file with the Clerk of the Circuit Court of Appeals, Ninth Circuit, that portion of the record in the above entitled matter as follows:

1. Petition for Writ of Habeas Corpus;
2. Order to Show Cause;
3. Return to Order to Show Cause;
4. Order Granting Motion to Set Aside Submission, Discharging Order to Show Cause, Terminating Restraining Order, and Denying Petition for Writ of Habeas Corpus;
5. Notice of Appeal;
6. All exhibits introduced in evidence for and on behalf of the petitioner above named.

Dated December 12, 1947.

FREITAS, DUFFY &
KEATING,
By WALTER F. FREITAS,
Attorneys for Petitioner.

(Affidavit of Service by Mail.)

[Endorsed]: Filed Dec. 13, 1947.

District Court of the United States
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 16 pages, numbered from 1 to 16, inclusive, contain a full, true, and correct transcript of the records and proceedings in the matter of Emanuel Stavros Houvardas, on Habeas Corpus, No. 27406-R, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of \$3.00 and that the said amount has been paid to me by the Attorney for the appellant herein.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 30th day of December, A. D. 194.....

[Seal]

C. W. CALBREATH,
Clerk,

By /s/ M. E. VAN BUREN,
Deputy Clerk.

[Endorsed]: No. 11822. United States Circuit Court of Appeals for the Ninth Circuit. Emanuel Stavros Houvardas, Appellant, vs. I. F. Wixon, District Director of Immigration and Naturalization, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed December 30, 1947.

/s/ PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

In the United States Circuit Court of Appeals
For the Ninth Circuit

No. 11822

In the Matter of

EMANUEL STAVROS HOUVARDAS,
On Habeus Corpus

(San Francisco Immigration
File No. 12020/32327)

STATEMENT OF POINT ON APPEAL AND
DESIGNATION OF RECORD ON APPEAL

To the Clerk of the United States Circuit Court
of Appeals for the Ninth Circuit:

Pursuant to Rule 19, Subdivision 6 of the Rule of Practice of the United States Circuit Court of Appeals for the Ninth Circuit you are respectfully notified that the petitioner above named submits herewith his statement of the point on which he intends to rely on the appeal in the above matter, said point being as follows:

Where an alien has been twice convicted of crimes involving moral turpitude, the alien may not be lawfully deported from the United States until he has been afforded an opportunity to apply for and to be heard on an application for a pardon within the meaning, purpose and intent of Section 155, Title 8, United States Code Annotated (Act of February 5, 1917).

You are further respectfully notified that the petition above named designates the following parts of the record in the above matter which he thinks necessary for the consideration of his point on appeal, to-wit:

1. The Petition for Writ of Habeas Corpus;
2. The Order to Show Cause;
3. The Return to the Order to Show Cause;
4. The Order Granting the Motion to Set Aside the Submission, Discharging the Order to Show Cause, Terminating the Restraining Order, and Denying the Petition for Writ of Habeas Corpus;
5. All of the exhibits introduced in evidence before the United States District Court, Southern Division of the United States, Northern District of California, for and on behalf of the petitioner above named.

Dated January 28th, 1948.

/s/ FREITAS, KEATING &
FREITAS,

/s/ JEROME A. DUFFY,
Attorneys for Petitioner.

[Affidavit of service by mail attached.]

[Endorsed]: Filed Jan. 29, 1948.

No. 11,822

IN THE

United States Circuit Court of Appeals
For the Ninth Circuit

EMANUEL STAVROS HOUVARDAS,
Appellant,

vs.

I. F. WIXON, District Director of Im-
migration and Naturalization,
Appellee.

OPENING BRIEF FOR APPELLANT.

JEROME A. DUFFY,
Freitas Building, San Rafael, California,
Attorney for Appellant.

FILED

APR 8 - 1948

PAUL P. O'BRIEN,
CLERK

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No. 11,822

IN THE
United States Circuit Court of Appeals
For the Ninth Circuit

EMANUEL STAVROS HOUVARDAS,
Appellant,

vs.

I. F. WIXON, District Director of Im-
migration and Naturalization,
Appellee.

OPENING BRIEF FOR APPELLANT.

PRELIMINARY STATEMENT.

Appellant is an alien who has resided continuously in California since 1912 after legally entering the United States from the Island of Samos, Greece.

On March 18, 1946, the Attorney General of the United States ordered appellant deported because since his entry appellant has been sentenced to a term of imprisonment more than once for a term of more than one year for the commission of crimes involving moral turpitude.

Appellant petitioned the United States District Court, for the Northern District of California, for a writ of habeas corpus. (R. 2-12.) The writ was de-

nied (R. 15) by District Judge Michael J. Roche, and this appeal followed. (R. 16.)

JURISDICTION.

Jurisdiction of the District Court to entertain the petition for habeas corpus is conferred by 28 U. S. C. §§ 451, 452. Jurisdiction of the Circuit Court of Appeals to review the District Court's final order denying habeas corpus is conferred by 28 U. S. C. § 463.

STATUTE INVOLVED.

The Act of February 5, 1917, as amended (8 U. S. C. § 155 (a)) so far as relevant to this proceeding, provides:

“* * * any alien who, after May 1, 1917, is sentenced to imprisonment for a term of one year or more because of conviction in this country of a crime involving moral turpitude, committed within five years after the entry of the alien to the United States, or who is sentenced more than once to such a term of imprisonment because of conviction in this country of any crime involving moral turpitude, committed at any time after entry; * * * shall, upon the warrant of the Attorney General, be taken into custody and deported. * * * *The provision of this section respecting the deportation of aliens convicted of a crime involving moral turpitude shall not apply to one who has been pardoned,* * * *”¹

¹Italics ours unless otherwise stated.

QUESTIONS PRESENTED.

1. Whether appellant may be lawfully deported from the United States without first affording him the opportunity to apply for and to be heard on his application for a pardon within the meaning, purpose and intent of 8 U. S. C. § 155 (a) (Act of February 5, 1917, as amended).

2. Whether appellant has been deprived of liberty or property without due process of law in ordering his deportation where his application for a pardon has not been finally determined or acted upon.

3. Whether the Attorney General, through the Immigration and Naturalization Service, has not heretofore recognized appellant's right to apply for and be heard on his pardon application by granting appellant a stay of the deportation proceedings to apply for such pardon.

SPECIFICATION OF ERRORS.

1. The District Court erred in denying the petition for a writ of habeas corpus and discharging the restraining order theretofore issued by the Court.

2. The District Court erred in failing to hold that the denial to appellant of the right or opportunity to apply for and be heard on a pardon application constituted a denial to appellant of the right to due process of law and of the equal protection of the law as guaranteed to him by the Fifth and Fourteenth Amendments to the Federal Constitution.

3. The District Court erred in failing to recognize appellant's right to apply for and be heard on his pardon application by ignoring the fact that the Immigration Department had heretofore recognized and acknowledged this right by staying the deportation proceedings so as to permit appellant to apply for a pardon.

STATEMENT OF THE CASE.

The appellant is a native of Greece. There is no dispute as to his alienage nor as to the lawfulness of his entry. He arrived in the United States on the S.S. "King Albert" in the month of March or April, 1912,—some thirty-six years ago,—when he was an eighteen year old boy. Upon his arrival at the Port of New York, N. Y., he was duly admitted for permanent residence in the United States by the Immigration authorities at said Port. Immediately after his arrival and clearance by the Immigration authorities the appellant proceeded directly to the State of California where he has maintained continuous residence for the past thirty-six years. The appellant is now fifty-four years of age. (R. 2-3.)

Misfortune first overtook the appellant when he was accused by the District Attorney of Los Angeles County in 1939 of two counts of forgery of a fictitious name. He was tried and found guilty by the Court on both of these counts, execution of sentence was suspended and he was placed on probation for a period of five years. (R. 3-4.)

Again in 1942 he was accused in Fresno County of violating Section 288-a of the California Penal Code. He pleaded guilty to this charge, moved for probation, probation was denied and he was sentenced on April 14, 1942 to imprisonment in the California State Prison at San Quentin. (R. 4.)

Thereafter, and on April 29, 1942, the Superior Court in and for the County of Los Angeles made and entered the following order concerning appellant:

“Probation having been heretofore revoked, the sentence imposed on February 14, 1939, committing the defendant to the California State Prison at San Quentin for the term prescribed by law as to each of Counts 1 and 2, *concurrently*, are placed into full force and effect. These sentences are ordered to run *concurrently* with State Prison sentence pronounced in Fresno County, which defendant is now serving.” (R. 5.)

On March 22, 1944, the California State Board of Prison Terms and Paroles made and entered an order fixing appellant's term of imprisonment. (R. 6-7.)

Appellant was confined at the State Prison at San Quentin until January 23, 1945, when he was released on parole. His parole will expire April 25, 1948, at which time appellant will have paid in full the penalties imposed upon him for his misdeeds and he will once more be a free man, his debt to society having been fully satisfied.

After his release from prison, and on or about September 12, 1946, appellant, through his then attorney, sought to apply for a pardon for his crimes to Hon-

orable Earl Warren, Governor of the State of California. The appellant, through his then attorney, was advised by the Governor's secretary that appellant's pardon application would be entertained only by the Governor upon compliance by the appellant with the provisions of the Procedure for Restoration of Rights and Application for Pardon as set forth in Sections 4852.01 to 4852.2 of the Penal Code.²

At this stage of the record appellant then found himself confronted with a provision of the pardon act, Section 4852.06 which provides:

“No such petition (for a pardon) shall be filed until and unless the petitioner has *continuously* resided, after leaving prison, in the county in which it is filed for a period of not less than *three years* immediately preceding the date of filing the petition * * *”

It is at once apparent that appellant, by virtue of this provision, became stalemated. His hands became legally tied and he was powerless to further attempt extricating himself from his predicament until he had first complied with the residential requirements of the statute. These requirements he fulfilled on January 23, 1948, and accordingly he is now free to pursue the first of the steps requisite to his application for a

²These provisions were enacted at the 1943 regular session of the California Legislature and added to the Penal Code by Stats. 1943, Chap. 400, effective May 13, 1943. The act is commonly known as the “Deuel bill” and was initiated and sponsored by Governor Warren.

pardon.³ On or after April 25, 1948, the termination date of his parole, appellant will then be permitted to file his Petition for a Certificate of Rehabilitation and Pardon. (Penal Code Section 4852.18.) This the appellant proposes to do without unnecessary delay.

The issues joined by the pleadings appear in the Transcript of Record on file herein. It would be repetitious and burdensome to this Honorable Court to restate the pleadings. Reference to the Record will disclose that the pleadings and the issues so raised thereby are essentially simple.

SUMMARY OF ISSUES AND LEGAL ARGUMENT.

From what heretofore has been related there becomes crystalized a simple, fundamental and vital issue, and an interpretation of the statute involved, which has not heretofore been passed upon or adjudicated by the Courts, is now called for. The issue is: *Whether an alien may be lawfully deported without first affording him the legal right to be heard on his application for a pardon. Conversely, may the government summarily banish or exile an alien from the country by cutting off his right to seek a pardon at a*

³On February 27, 1948, appellant filed with the County Clerk of Marin County, California, a Notice of Intention to Apply for Certificate of Rehabilitation and Pardon as required by Penal Code, Section 4852.01, and on the same date caused to be served upon the Chief of Police of the City of San Rafael, a certified copy of the notice of intention filed with the County Clerk. (Penal Code, Section 4852.02.)

time when this right is in the orderly process of fruition; when the right is available to him; and when the right has not been exhausted?

POINT I.

THE PLAIN INTENDMENT OF THE ACT OF FEBRUARY 5, 1917,
IS THAT A PARDON BARS DEPORTATION.

“The provision of this section (8 U. S. C. 155 (a)) respecting the deportation of aliens convicted of a crime involving moral turpitude *shall not apply to one who has been pardoned, * * **”

It clearly follows that executive clemency is distinctly intended by the Congress to operate as a complete bar to deportation. This is definitely recognized by the Courts, as was held in *U. S. ex rel. Kowalenski v. Flynn*, 17 F. (2d) 524, that disabilities growing out of an offense requiring deportation are removed by pardon.

In the lower Court the appellee's sole point of insistence was that the words of the statute “has been pardoned” must be taken literally, and the past tense having been employed, that the statute cannot be construed to mean a pardon in the future. This contention suggests the weird notion that a pardon is of no avail to an alien unless he is possessed of it at the very time he is served with a warrant of deportation, and possibly until he is in the act of being removed physically from the country. Let us analyze this absurdity.

At the outset, the section under discussion, is *penal* in its nature, and hence any doubt concerning the application thereof should be resolved favorably to the alien. See: *Wallis v. Tecchio*, 65 F. (2d) 250.

The following are some of the relevant rules on statutory interpretation:

When unambiguous language in a statute produces ambiguous results or manifest injustice, the Court must give it an application reasonably within intent of law.

Tillinghast v. Tillinghast, 25 F. (2d) 531.

It is well settled law that, where a strict construction of a statute leads to injustice, absurdity and incongruity, the Court will look to the purpose and the spirit of the statute in declaring its effect.

In re Cahn, Belt & Co., 27 App. D. C. 173;

Fields v. United States, 27 App. D. C. 433;

United States v. Day, 27 App. D. C. 458;

Moss v. United States, 29 App. D. C. 188;

Garrison v. Dist. of Columbia, 30 App. D. C. 515;

Dist. of Columbia v. Dewalt, 31 App. D. C. 326.

In the case of *In re Cahn, Belt & Co.*, supra, at page 181, the Court quoted with approval from Lewis' *Sunderland*, Stat. Const. §633, as follows:

“The *intent* is the vital part, the essence of the law, and the primary rule of construction is to ascertain and give effect to that intent. ‘The intention of the Legislature in enacting a law is the law itself, and must be enforced when ascer-

tained, although it may not be consistent with the strict letter of the statute. Courts will not follow the letter of a statute, when it leads away from the true intent and purpose of the Legislature and to conclusions inconsistent with the general purpose of the act.' ”.

“In pursuance of the general object of giving effect to the intention of the legislature, the Courts are not controlled by the literal meaning of the language of the statute, but the spirit or intention of the law prevails over the letter thereof, *it being generally recognized that whatever is within the spirit of the statute is within the statute although it is not within the letter thereof, while that which is within the letter, although not within the spirit, is not within the statute.* Effect will be given the real intention even though contrary to the letter of the law. The rule of construction according to the spirit of the law is especially applicable where adherence to the letter *would result in absurdity or injustice, or would lead to contradictions, or would defeat the plain purpose of the act,* or where the provision was inserted through inadvertence. *In following his rule, words may be modified or rejected and others substituted, or words and phrases may be transposed.*”

59 C. J. 964-968;

Fleischmann Constr. Co. v. U. S., 270 U. S. 349,
70 L. Ed. 624;

Barrett v. Van Pelt, 268 U. S. 85, 69 L. Ed. 857;
Takao Ozawa v. U. S., 260 U. S. 178, 67 L. Ed.
199;

Holy Trinity Church v. U. S., 134 U. S. 457,
26 L. Ed. 226;

U. S. v. Katz, 271 U. S. 354, 70 L. Ed. 986.

“In the interpretation of statutes courts are not bound by *grammatical* rules, and may ascertain the meaning of words by the context.”

In re Haines, 195 Cal. 605 at 613.

With the foregoing salutary rules in mind, it is a once plain that the words “has been pardoned” were not meant to be operative in their strict, literal or grammatical sense. Congress employed the words *generally*, to connote the idea that a pardon whenever lawfully obtained, *past, present or future*, effectively and automatically will place the alien beyond the reach of the Immigration authorities and remove the peril of deportation. Otherwise, an absurd result would follow and the intention of Congress rendered meaningless. For example: Let us assume the case of an alien, who since May 1, 1917, was sentenced to imprisonment for a crime involving moral turpitude. While incarcerated the Immigration authorities notify the prison officials that they wish a hold placed on the alien prisoner. Upon completion of his sentence, he is immediately served with a warrant of deportation, taken before an Immigration Commissioner, heard and ordered deported. Wherein has the alien either the time, the opportunity or the right to apply for a pardon? Wherein is the intention of Congress allowed to be pursued in orderly and legal fashion?

Again, an alien has been once imprisoned for the type of crime denounced. He again is convicted of that class of crime and is undergoing a sentence of imprisonment. It would therefore follow, according to appellee's view of the statute, that the alien would have to obtain a pardon on his *first* conviction, or suffer *immediate* deportation after release for service of sentence on his *second* conviction. This is so, because it is conceivable that while undergoing sentence on his *second* conviction a deportation warrant could issue, a hearing held and deportation ordered, all at time while the alien was in penal custody, and powerless to either ask for or receive a pardon, so that upon his release he could be taken immediately by the Immigration authorities and without further adieu transported out of the country. Is this what Congress meant when it declared that a pardon bars deportation?

To otherwise hold, or to give effect to appellee's view of the construction to be given the statute, would in effect be placing the imprimatur of this Court on kidnapping by the Government.

POINT II.

**TO DENY THE RIGHT TO LAWFULLY APPLY FOR A PARDON
IS TO DENY THE RIGHT TO DUE PROCESS OF LAW.**

The appellant is not unmindful of the general rule in cases of this character, namely, that it is not the primary function of this Court to try the right of the alien to enter or remain in the United States, but the power of this Court is limited to ascertaining whether

or not the record shows that the proceedings in the matter are either unfair or otherwise lacking in the essential elements of due process of law, or that the Immigration Authorities are proceeding on an erroneous view of the law. If it thus appears to this Court that the proceedings in the instant case reflect any interference with the appellant's right to be fairly heard, then this Court must review the case. The statute in question by enumerating the conditions upon which deportation will lie naturally prohibits deportation in other cases. Therefore, when the record shows that the Immigration officials are exceeding their power by either departing from the plain intent of the statute or completely ignoring it, the alien may then properly demand his release from deportation upon habeas corpus.

The appellant does not assert that he has any vested right to remain in this country, but he most vigorously asserts that he has the right to exhaust the rights conferred upon him by Congress. He asserts that he has the right to lawfully apply in accordance with law for a pardon. If deportation is permitted to cut off the orderly process of this alien's application for a pardon, then the alien's right to due process of law as guaranteed is denied him.

It requires no citation of authority to sustain the principle that aliens, as well as citizens, are entitled to apply for, be heard upon and be granted pardons for their crimes.

To obtain a pardon it must be applied for. Other than the rare cases of a general amnesty, the essential

act of applying for a pardon must be initiated by the person who hopes to be the recipient thereof. A pardon does not descend as grace from on High to a supine sinner. The Congress has not set forth in the statute any mode or procedure to be followed. These procedural matters and the minutia of detail therewith connected are evidently left to the several states in accordance with their respective and various pardon statutes. However, there can be no mistake that Congress has definitely and emphatically declared that a pardon will relieve the alien from the dire consequences of deportation. "*Ubi Jus Ibi Remedium*" is the underlying thought of Congress in this respect.

Therefore, any interference with the orderly procedure toward the end of a proper presentation of appellant's request for a pardon or the prevention from obtaining a hearing on his pardon application is a complete deprivation of appellant's liberty and property without due process of law.

POINT III.

THE IMMIGRATION SERVICE IN HERETOFORE STAYING DEPORTATION PROCEEDINGS TO AFFORD APPELLANT THE OPPORTUNITY TO APPLY FOR A PARDON, HAS CONCEDED THAT APPELLANT MAY NOT BE DEPORTED UNTIL HE HAS FIRST EXHAUSTED HIS RIGHT TO BE FULLY HEARD ON HIS PARDON APPLICATION.

The record shows (Appellant's Exhibits "A" and "B" and Appellant's Exhibit "A" in evidence) that heretofore the appellant made application to the Immigration Service for a stay of the deportation pro-

ceedings (after a deportation warrant had issued) and that the proceedings were stayed to "afford opportunity" to "secure pardon" (Appellant's Exhibit "A").

The Commissioner of Immigration, according to File No. 5-489275 in evidence as Appellee's Exhibit "A", is of record as stating on May 16, 1946:

"Subsequently, information was submitted showing that application for pardon in behalf of the alien was being made and the request is now made that deportation of the subject scheduled for May 17, 1946 be stayed. *Under the circumstances, this request may be granted.*"

The conduct of the Immigration Service in this respect calls for the application of the principles of contemporaneous construction, which when applied to the facts of the case at bar clearly demonstrates that the principle contended for by appellant is definitely recognized and subscribed to by the appellee.

"The contemporaneous construction placed upon a statute by the officers or departments charged with the duty of executing it is entitled to more or less weight, especially if such construction has been made by the highest officers in the executive department of the Government, * * * and, while not generally controlling, where the case is not extreme and no vested rights are involved, such construction should not be disregarded or overturned except for the most cogent reasons and unless clearly erroneous. * * * The consideration to be accorded executive consideration is also especially weighty in the case of stat-

utes prescribing penalties or levying impositions, where the executive construction has been in favor of the persons affected.” 59 C. J. 1025.

This rule has been applied in numerous instances by United States courts, among which cases are the following:

United States v. Jackson, 74 Law. Ed. 369;

Brewster v. Gage, 74 Law. Ed. 457, at p. 463.

The purpose of acquainting the Court with the foregoing rules relative to contemporaneous construction is the fact that under date of May 14, 1946 the petitioner's then counsel, by telegram to the head of the Immigration and Naturalization Service at Philadelphia, Pa., in view of then imminent deportation proceedings, made application for a re-opening of the case and likewise for a stay of proceedings upon the further ground that petitioner was taking steps to seek a pardon.

Thereafter and on May 16, 1946, the Assistant Commissioner of the Immigration and Naturalization Service by telegram advised petitioner's then counsel that the deportation of the petitioner was stayed thirty days to afford opportunity to secure a pardon.

Thereafter, by letter the Immigration Service was advised that the thirty day extension was not sufficient in view of the laws of California relative to the applications for pardons and additional time was sought to accomplish this purpose, but the Immigration Service did not see fit to grant additional time.

We believe that the Immigration Service, in acting on the request to apply for a pardon, recognized the right of an alien to apply for a pardon, and by its acts in granting a stay of proceedings to apply for the pardon, has placed a construction upon the terms of the statute in question as contended for by the petitioner, namely, the Department has recognized by its own affirmative act the right to apply for a pardon. We believe that the doctrine of contemporaneous construction, therefore, becomes applicable.

CONCLUSION.

Diligent research has failed to find any case construing the particular phrase of the statute in question. The point, raised by the appellant, therefore, is one of first impression, the answer to which is of momentous import to the appellant. Deportation to Greece during these perilous times would be in effect the exiling of the appellant to a foreign land. For thirty-six years he has lived in this country and has become Americanized in his way of life. Every humane instinct rebels at the thought of an alien in such an unfortunate web of circumstance being summarily banished from this country when legal rights are still available to him to prevent his deportation.

We can find no more pungent expression evaluating the intent of the Congress as to the very section in question than that employed by Mr. Justice Douglas in the recent case of *Tan v. Phelan*, Opinion No. 370, October Term, 1947, decided February 2, 1948:

“We resolve the doubts in favor of that construction because deportation is a drastic measure and at times the equivalent of banishment or exile, *Delgadillo v. Carmichael*, 333 U. S. —. It is the forfeiture for misconduct of a residence in this country. Such a forfeiture is a penalty. To construe this statutory provision less generously to the alien might find support in logic. But since the stakes are considerable for the individual, we will not assume that Congress meant to trench on his freedom beyond that which is required by the narrowest of several possible meanings of the words used.

Reversed.”

Dated, San Rafael, California,
April 8, 1948.

Respectfully submitted,

JEROME A. DUFFY,

Attorney for Appellant.

No. 11,822

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

EMANUEL STAVROS HOUVARDAS,

Appellant,

VS.

I. F. WIXON, District Director of Im-
migration and Naturalization,

Appellee.

BRIEF FOR APPELLEE.

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No. 11,822

IN THE

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EMANUEL STAVROS HOUVARDAS,
Appellant,

vs.

I. F. WIXON, District Director of Im-
migration and Naturalization,
Appellee.

BRIEF FOR APPELLEE.

THE FACTS OF THE CASE.

The appellant is a native of Greece. He claims to have last entered the United States in March or April, 1912 or 1913, at the Port of New York City, New York, as a passenger. The local office of the Immigration and Naturalization Service was unable to verify his claimed entry into the United States. (Exhibit A, Record of Hearing of September 27, 1943—Exhibit 2.) He claims to have lived in the United States continuously since this entry, and appellant is now fifty-four years of age. (R. 2-3.)

Appellant was first convicted of a violation of the laws of the United States in Los Angeles County on

an indictment in two counts alleging forgery of a fictitious name. He was tried and found guilty on both of these counts on February 14, 1939. Execution of sentence was suspended, and he was placed on probation for a period of five years. (R. 3-4.)

Later, on April 14, 1942, he was convicted of a crime of lewd and lascivious conduct and sentenced to the State Prison at San Quentin for the term prescribed by law (0 to 15 years). (R. 4.) On April 29, 1942, the Superior Court in and for the County of Los Angeles made and entered the following order, to-wit:

“Probation having been heretofore revoked, the sentences imposed on February 14, 1939, committing this defendant to the California State Prison at San Quentin for the term prescribed by law as to each of Counts 1 and 2, concurrently, are placed into full force and effect. These sentences are ordered to run concurrently with State Prison sentence pronounced in Fresno County, which defendant is now serving.” (R. 5.)

On March 22, 1944 the California State Board of Prison Terms and Paroles made and entered an order fixing appellant's term of imprisonment at confinement in the State Prison for ten years and ten years. C.C. (R. 6-7.)

Appellant was confined in the State Prison at San Quentin until January 23, 1945, when he was released on parole. Such parole expired on January 23, 1948. (R. 7.)

On or about September 12, 1946, appellant, through his then attorney, sought to apply for a pardon for his crimes to the Honorable Earl Warren, Governor of the State of California, who refused to entertain the application. (R. 5-6.) Appellant admits that he has never secured a pardon from the executive authority of the State of California. (R. 9.)

SUMMARY OF ISSUES AND LEGAL ARGUMENT.

The fundamental issue in this case is whether the action of the Attorney General of the United States in ordering the deportation of the appellant under 8 U.S.C. 155 is arbitrary and unlawful in that he does not extend to appellant an unlimited period of time in which to apply for a pardon, and to read into Section 155(a) Title 8 U.S.C.A. a provision staying the deportation of an alien until he has made one or more applications to the proper executive authority for a pardon for his offenses.

Section 155(a) Title 8 U.S.C.A. reads as follows:

“* * * except as hereinafter provided, any alien, who, after May 1, 1917, is sentenced to imprisonment for a term of one year or more because of conviction in this country of a crime involving moral turpitude, committed within five years after the entry of the alien to the United States, or *who is sentenced more than once to such a term of imprisonment because of conviction in this country of any crime involving moral turpitude committed at any time after entry,* * * * shall, upon the warrant of the Attorney General,

*be taken into custody and deported * * *.*" (Italics supplied.)

"The provision of this section respecting the deportation of aliens convicted of a crime involving moral turpitude shall not apply to one who *has been pardoned*, nor shall such deportation be made or directed if the court, or judge thereof, sentencing such alien for such crime shall, at the time of imposing judgment or passing sentence or within thirty days thereafter, due notice having been given to representatives of the State, make a recommendation to the Attorney General that such alien shall not be deported in pursuance of this chapter. * * *." (Italics supplied.)

Congress has specifically legislated on the subject of deportation after release from imprisonment. 8 U.S.C.A. 180(b) provides:

"An alien sentenced to imprisonment shall not be deported under any provision of law until after the termination of the imprisonment. *For the purposes of this section, the imprisonment shall be considered as terminated upon the release of the alien from confinement whether or not he is subject to rearrest or further confinement in respect of the same offense.* (Italics supplied.)

The purpose and object which this section was intended to serve and accomplish are stated in the report (H.R. 2418, 70th Congress, Second Session) of the House Committee on Immigration and Naturalization in reporting on Bill S 5094, which became the Act of March 4, 1929, (now 8 U.S.C.A. 180). With reference to Section 5 of that bill which, with a slight

revision, was enacted as Section 3 of the 1929 Act (now 8 U.S.C.A. 180), the Committee said (p. 8):

“In the case of prisoners released on parole under convictions by State courts, it was the practice of the department until recently to take the prisoner into custody immediately on his parole if deportable for any reason. Objections were made by one of the States to this practice, on the ground that it was an infringement on the right of the State to retain custody of the prisoner during the period he is out on parole. The Solicitor of the Department of Labor recently advised the Secretary of Labor that the statute did not authorize the practice of the Department, and accordingly it has been discontinued so that under the present law the alien is not deported until the end of the term for which sentenced or until he is unconditionally released from confinement. Your committee is convinced that the law should be made clear that the alien is deportable immediately upon his release from confinement. If he belongs to a deportable class he should be deported even though it may not be against the public policy of the State, under whose laws he has been convicted, that he should be allowed to go at large on parole. The authority of Congress in relation to deportation of aliens is supreme and the law or practice of a State can not and should not allow an alien to remain in this country for a moment longer than permitted by the act of the National Legislature, which alone is charged with the duty and responsibility of ridding the country of undesirable aliens. Accordingly, section 5 of the bill provides that the alien may be deported immediately upon his release on parole.”

It has since been judicially well settled that release from confinement on parole is a termination of imprisonment and that a deportable alien thus released from confinement becomes immediately subject to deportation. (Section 3, Act of March 4, 1929 (8 U.S.C. 180(b)); Section 19, Act of Feb. 5, 1917 as amended (8 U.S.C. 155); Act of Jan. 19, 1929 (21 U.S.C. 237); Act of March 2, 1931 (18 U.S.C. 716; *Lu Woy Hung v. Haff*, 78 F. (2d) 836 (C.C.A. 9, 1935), and cases cited therein; 8 C.F.R. 150.12(b)). See also *U. S. ex parte Rupert*, 38 F. Supp. 153 (D. C. Tex., 1941) holding that a parole is not to be considered a pardon, as it is mere liberty under supervision. See *In the Matter of Szie Ben Eng*, 27735-G, March 16, 1948, D. C. N. D. Calif.

In the instant case the alien is deportable for a criminal offense under Section 19(a) of the Immigration Act of February 5, 1917 (8 U.S.C. at 155(a)) on the warrant charge: Sentenced more than once because of conviction of crimes committed after entry, to-wit: Forgery of fictitious name with intent to defraud; Lewd and lascivious conduct. Under the provisions of Section 19(d) of the same act (8 U.S.C. 155(d)) this class of deportable criminal aliens are excluded from discretionary relief provided by Section 19(c) of the same act (8 U.S.C. 155(c)) for voluntary departure or suspension of deportation. This petitioner's deportation is therefore mandatory, and by operation of Section 3 of the Act of March 4, 1929, *supra*, he became immediately subject to

deportation upon his release from confinement on parole.

But under the provisions of Section 19(a) of the Immigration Act of February 5, 1917 (8 U.S.C. 155(a)) an alien convicted in the United States of a crime involving moral turpitude, as here, is not deportable for that reason if he *has been granted a full pardon*. Since this petitioner has not been granted such pardon, he remains deportable. He nevertheless has heretofore sought, administratively to obtain stays of deportation to permit him to apply for such a pardon in the State of California. On May 16, 1946 he was administratively granted a stay of deportation for a period of thirty days. Thereafter his attorney filed a motion that the case be reopened for the introduction of new evidence. The motion was denied on May 23, 1946, and the order of denial was affirmed by the Board of Immigration Appeals on June 6, 1947. Later, his counsel stated that he had been taking the preliminary steps necessary to the presentation of the alien's application for a pardon and that as the procedure is long and involved, he requested a further stay of ninety days within which to complete and have a determination of the alien's application for pardon. This was administratively denied. He now petitions in habeas corpus.

The scope of judicial review of deportation proceedings in habeas corpus is extremely narrow, since the decision of the Attorney General, or of a board of special inquiry if not appealed, is final and gen-

erally may not be disturbed by the courts in habeas corpus proceedings if supported by some substantial evidence, if it was made after a fair hearing, and no error of law was committed.¹ Even in those cases where

¹The deportation of aliens unlawfully in the United States is by statute committed to the Attorney General. Section 19 of the Immigration Act of 1917, as amended (39 Stat. 889-890; 54 Stat. 671-673; 56 Stat. 1044; 8 U. S. C. 155) provides that in deportation cases "The decision of the Attorney General shall be final." The statutes make no provision for judicial review and the finality of such administrative determinations has been repeatedly confirmed by the courts since the earliest immigration cases. *Kishimura Ekin v. United States*, 142 U. S. 631, 660 (1892); *Fong Yue Ting v. United States*, 149 U. S. 698 (1893).

All attempts to secure direct judicial review or intervention in deportation cases have been flatly rejected by the courts, regardless of the basis on which jurisdiction has been alleged. The Courts have held themselves without jurisdiction to entertain a bill in equity to cancel an order of deportation, *Fafalios v. Doak*, 50 F. (2d) 640 (App. D. C. 1931), certiorari denied 264 U. S. 651; a bill in equity for injunction, *Dash v. Turbrick*, 6 F. Supp. 390 (S. D. Mich. 1934), *Bata Shoe Co. v. Perkins*, 33 F. Supp. 508 (D.C. D. C., 1940); a bill in equity for a declaratory judgment, *Darabi v. Northrup*, 54 F. (2d) 70 (C.C.A. 6, 1931); a petition for writ of certiorari, *In re Ban*, 21 F. (2d) 1009 (W.D. N. Y., 1927); a petition for writ of prohibition, *Poliszek v. Doak*, 57 F. (2d) 430 (App. D. C. 1932) *Kabadian v. Doak*, 65 F. (2d) 202 (App. D. C. 1933) certiorari denied 290 U.S. 661; a petition to compel return of evidence allegedly illegally procured, *Impiriale v. Perkins*, 66 F. (2d) 805 (App. D. C. 1933) certiorari denied 290 U.S. 690; a petition for review under Section 10 of the Administrative Procedure Act, *U. S. ex rel., Trinler v. Carusi*, 72 Fed. Supp. 193.

The courts, of course, have passed upon deportation cases in habeas corpus proceedings. Habeas corpus, however, does not provide a direct judicial review, such as is provided by appeal or writ of error. Habeas corpus is not a proceeding in the original suit, but is an independent civil suit. *Middle v. Dyche*, 262 U.S. 333 (1923). It is a collateral review. *U. S. ex rel. Vajtauer v. Commissioner*, 273 U. S. 103 (1927). It stems, not from any right of judicial review, but from the due process clause of the Fifth Amendment to the Federal Constitution. Its purpose is to inquire "into the cause of restraint of liberty" (R.S. 752; 28 U.S.C. 452) and it is not available to one who, though anticipating arrest, is

administrative authorities are authorized by particular provisions of statute to exercise their discretion in deportation proceedings, as in considering applications for voluntary departure or suspension of deportation under Section 19 (c) of the Immigration Act of 1917, the Courts have no proper control over the discretion thus exercised unless the action taken

not yet in custody. *Wales v. Whitney*, 114 U.S. 564 (1885); *Stallings v. Splain*, 253 U.S. 339 (1920); *Sibray v. United States*, 185 Fed. 401 (C.C.A. 3, 1911); *Ex parte Musci*, 1 F. Supp. 587 (S.D. N. Y. 1922); *Doss v. Lindsley*, 53 F. Supp. 427 (E.D. Ill., 1944). It is not available as a matter of right, and the Court may refuse to issue the writ when it appears from the petition that the party is not entitled thereto. 14 Stat. 385; 28 U.S.C. 455; *Walker v. Johnston*, 312 U.S. 275 (1941).

Moreover, the scope of judicial review on habeas corpus is extremely narrow. The administrative findings of fact are conclusive, if supported by some evidence of probative value, and are not open to attack merely by showing that they are wrong. *U. S. ex rel. Vajtauer v. Commissioner*, supra; *Tisi v. Tod*, 264 U.S. 109, 133 (1924). The courts do review the administrative conclusions of law involving interpretation of the statutory grounds for deportation, *Mahler v. Eby*, 264 U. S. 32 (1924); *Kessler v. Strecker*, 307 U.S. 22 (1939); *Bridges v. Wixon*, 326 U.S. 135 (1945), since the administrative authorities have no power to deport for a ground not listed in the statutes. Similarly, the courts on habeas corpus will determine a petitioner's charge that the administrative hearing was unfair, *Tod v. Waldman*, 266 U.S. 113 (1924), or that he has been in custody for an unreasonable length of time, *Ross v. Wallis*, 279 Fed. 401 (C.C.A. 2, 1922).

The Immigration statutes contemplate that the administrative determinations, when made within the scope of the statutory authority, shall be final. Where the immigration officials have exceeded or abused their authority, the writ of habeas corpus provides "an adequate and complete remedy." *Fafalios v. Doak*, supra. Narrow in scope as it is, therefore, the review by habeas corpus is "the only available procedure to determine whether the immigration authorities have exceeded or abused their power." *Wong Sun v. Fluckey*, 288 Fed. 989, 994 (N.D. Ohio, 1922).

constitutes denial of due process of law.² Stays of deportation are acts of administrative discretion, as distinguished from authority to grant discretionary relief such as arises under Section 19 (c), previously referred to. Administrative discretion in granting stays is sometimes exercised in cases arising from transportation difficulties, physical condition of aliens, and various other exceptionable and justifiable circumstances including situations where, in cooperation with other authorities, deportable aliens may be needed as witnesses. Cooperative administrative discretion has also been exercised to grant stays where there is sound reason to believe that pending legislation or applications for pardon or other proceedings are likely to result in action that may remove a legal basis for deportation. However, where the discretion is not exercised in favor of the alien the courts, under the well-defined limits of habeas corpus proceedings previously referred to, have no authority to control the discretion nor to review the deportation proceedings unless on the fundamental issues of whether there is sufficient evidence, whether there has been a fair hearing, and whether any error of law has been committed. Unless such issues are involved, it is be-

²*Kazue Sumi v. Carmichael*, 118 F. (2d) 707 (C.C.A. 9, 1941); *Boraca v. Schlotfeldt*, 109 F. (2d) 106 (C.C.A. 7, 1940); *Stone ex rel. Colonna v. Tillinghast*, 32 F. (2d) 447 (C.C.A. 1, 1929); *Ickowitz v. Day*, 18 F. (2d) 962 (C.C.A. 2, 1927); *Chanin v. Williams*, 177 F. 689 (C.C.A. 2, 1910); *Katnic v. Reimer*, 25 F. Supp. 925 (D.C. N.Y. 1938); *Ex parte Panagopoulos*, 3 F. Supp. 222 (D.C. Calif. 1933); *Kutas v. Williams*, 204 F. 847 (D.C. N. Y., 1913); *Bjorkens v. Watkins*, U. S. District Court, Southern District of New York, March 28, 1945, unreported, Civil 30-84.

lieved the decision of the administrative authorities is final and beyond the power of the Court to disturb. (Footnotes 1 and 2, *supra*.)

No doubt because of the well-defined limits of habeas corpus proceedings, relatively few petitions have been filed since enactment of Section 3, Act of March 4, 1929, where the sole or predominant relief sought was a stay of deportation by an alien on parole until he could apply for a pardon. No such cases limited exclusively to this issue have been identified as arising since the end of the war, with the resumption of active deportations and consequent habeas corpus actions. Even the older cases, extending back to 1930, reflect generally that petitioners did not rely upon the Courts to grant such relief. Situations did arise where aliens ordered deported raised issues as to whether their release from confinement was on parole or probation, or whether either operated as a conditional pardon, etc. But in the absence of such issues, petitioners usually sought review and release on the substantial issues within the limits of habeas corpus, and apparently did not press any contention that the Courts had authority to stay their deportations where the parole had not expired.

Appellant contends that in issuing the instant warrant for his deportation, the Attorney General of the United States acted in excess of his powers and of the jurisdiction conferred upon him by the statutes of the United States.

Appellant contends that the words "has been pardoned" should read "who may be pardoned in

the future." Such a construction would do violence to the phraseology actually used in this section of the law. The construction contended for by the appellant would actually prevent the deportation of all aliens under Section 155 (a) Title 8 U.S.C.A., because it would be impossible in any case for the Attorney General to determine whether or not an alien held for deportation under the provisions of this section might at some indefinite time in the future receive the favorable consideration of the executive authority authorized to pardon his offenses, such action, of course, being entirely conjectural.

The appellant further contends that unless his petition is granted under the Fourteenth Amendment to the Constitution of the United States, he would be denied his liberty without due process of law and the equal protection of the law. If, as held by the appellee, he is held in custody under a valid warrant of the Attorney General for his deportation, it would seem to necessarily follow that he is being held in lawful custody.

It is submitted that the words "has been pardoned" refer to the condition of the alien at the time of his being taken into custody for deportation under a lawful warrant.

It might be well to state that an alien residing in this country is subject at all times to the power of Congress to legislate on all matters which might prohibit or limit his stay in this country.

U. S. ex rel. Feuer v. Day, Commissioner of Immigration, C.C.A. 2nd, decided May 5, 1930, 42 Fed. (2d) 127.

CONCLUSION.

1. The construction of Section 155 (a) Title 8 U.S.C.A., sought by appellant to read into this section the words "may be pardoned in the future" would lead to absurd results.

2. There is no denial of the right of due process of law on the part of the Attorney General of the United States when he sees fit in the exercise of his discretion to deny an application for administrative relief.

3. That by reason of the indulgence of the Attorney General in granting to the appellant certain stays of deportation, that official has in no wise admitted that as a matter of right the appellant was entitled to such consideration.

Appellee is, therefore, of the belief that the judgment of the District Court of the United States for the Southern Division of the Northern District of California denying appellant's petition for a writ of habeas corpus was proper and that the decision of the Court below should be affirmed.

Dated, San Francisco, California,

May 3, 1948.

Respectfully submitted,

FRANK J. HENNESSY,

United States Attorney,

E. R. BONSALL,

Assistant United States Attorney,

Attorneys for Appellee.

No. 11823

United States
Circuit Court of Appeals
For the Ninth Circuit

LEO M. HARVEY and LENA P. HARVEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petitions to Review a Decision of the Tax Court
of the United States

FILE

AUG 5 - 1948

PAUL P. O'BRIEN,
CLERK

No. 11823

United States
Circuit Court of Appeals
For the Ninth Circuit

LEO M. HARVEY and LENA P. HARVEY,
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

GEORGE T. ALTMAN.

For Comm'r.:

R. C. WHITLEY,

E. A. TONJES.

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1945

- Feb. 12—Petition received and filed. Taxpayer notified. Fee paid. 4 copies received 2/15/45.
- Feb. 15—Copy of petition served on General Counsel.
- Mar. 19—Answer filed by General Counsel.
- Mar. 19—Request for hearing in Los Angeles, California, filed by General Counsel.
- Mar. 23—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.
- Apr. 2—Motion for judgment on the pleadings, and to set same on Los Angeles calendar for hearing filed by taxpayer.
- Apr. 18—Hearing set on petitioner's motion 5/16/45.
- Apr. 18—Copy of motion and notice of hearing served on General Counsel.
- May 14—Notice of submission under Rule 30 with brief in support attached filed by taxpayer. 5/15/45 Copy served on General Counsel.

1945

May 16—Hearing had before Judge Murdock on petitioner's motion for judgment on the pleadings. Ordered C.A.V. Respondent's memorandum in opposition to motion filed at hearing.

May 17—Motion of April 2 for judgment on pleadings denied.

1946

Sept. 6—Motion for leave to amend petition embodying amendment filed by taxpayer.

Sept. 11—Hearings set Nov. 4, 1946, Los Angeles.

Sept. 11—Hearing set 10/9/46 on petitioner's motion.

Sept. 11—Copy of motion and notice of hearing served on General Counsel.

Sept. 18—Motion to transfer the motion to amend petition set for hearing 10/9/46, Washington, D. C., to the merit calendar of Nov. 4, 1946, Los Angeles, filed by taxpayer. 9/20/46 copy served.

Oct. 9—Hearing had before Judge Turner on petitioner's motion to amend petition granted.

Oct. 9—Order that petitioner's motion to amend petition filed 9/6/46 is granted, entered.

Nov. 4—Hearing had before Judge Hill on merits. Motion of counsel to consolidate dks. 7116 and 7117 granted. Oral motion of Petitioner to file amendment to petition granted. Motion of respondent to file answer to amendment to petition and answer

to petition as amended granted. Motion and amendment to petition, answer to amendment to petition and answer to petition as amended filed at hearing and served. Briefs due 12/23/46; replies due 1/22/47. [1*]

1946

Dec. 4—Transcript of hearing 11/4/46 filed.

Dec. 4—Transcript of hearing 11/8/46 filed.

Dec. 17—Brief filed by taxpayer.

Dec. 18—Motion for extension to Jan. 23, 1947, to file brief and to Feb. 22, 1947, to file both reply briefs filed by General Counsel. 12/19/46 Granted.

1947

Jan. 6—Supplement to brief filed by taxpayer. 1/16/47 Copy served.

Jan. 15—Brief filed by General Counsel.

Jan. 29—Reply brief filed by taxpayer. 1/29/47 Copy served.

Feb. 7—One page addition to reply brief filed by taxpayer. 2/7/47 copy served.

Feb. 12—Reply brief filed by General Counsel.

Mar. 24—Memorandum findings of fact and opinion rendered. Judge Hill. Decision will be entered under Rule 50. 3/24/47 copy served.

Apr. 28—Motion for extension to five days to file a motion for rehearing filed by taxpayer. Granted.

*Page numbering appearing at top of page of original certified Transcript of Record.

1947

Apr. 28—Motion for a rehearing filed by taxpayer.

Apr. 29—Order amending memorandum findings of fact and denying petitioner's motion for rehearing entered.

June 4—Respondent's computation for entry of decision filed.

June 6—Hearing set July 16, 1947, Washington, D. C., on Rule 50.

July 16—Hearing had before Judge Hill on settlement. No contest. Ordered Respondent's computation. Judge Hill for order.

July 17—Decision entered, Judge Hill, Div. 2.

July 22—Order amending decision, entered.

Oct. 17—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.

Oct. 17—Proof of service filed.

Nov. 24—Certified copy of an order from the Ninth Circuit for enlargement of 40 days to file transcript of record filed.

Nov. 24—Certified copy of an order from the Ninth Circuit directing the Clerk of the Tax Court to transmit to the Clerk of the Circuit Court the original petitioner's exhibit 1 and respondent's exhibits A through K 15 days prior to the hearing filed.

Nov. 25—Designation of record filed by taxpayer with proof of service thereon. [2]

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1945

- Feb. 12—Petition received and filed. Taxpayer notified. Fee paid. Copy received 2/15/45.
- Feb. 15—Copy of petition served on General Counsel.
- Mar. 19—Answer filed by General Counsel.
- Mar. 19—Request for hearing in Los Angeles, Calif., filed by General Counsel.
- Mar. 23—Notice issued placing proceeding on Los Angeles, Calif., calendar. Service of answer and request made.
- Apr. 2—Motion for judgment on the pleadings and to set same on Los Angeles, Calif., calendar for hearing filed by taxpayer.
- Apr. 18—Hearing set on petitioner's motion for 5/16/45.
- Apr. 18—Copy of motion and notice of hearing served on General Counsel.
- May 14—Notice of submission under Rule 30 with brief in support attached filed by taxpayer. 5/15/45 copy served on General Counsel.

1945

- May 16—Hearing had before Judge Murdock on petitioner's motion for judgment on the pleadings. Ordered C.A.V. Respondent's memorandum in opposition to motion filed at hearing.
- May 17—Motion of April 2, for judgment on pleadings denied.

1946

- Sept. 6—Motion for leave to amend petition embodying amendment filed by taxpayer.
- Sept. 11—Hearing set Nov. 4, 1946, Los Angeles.
- Sept. 11—Hearing set 10/9/46 on petitioner's motion.
- Sept. 11—Copy of motion and notice of hearing served on General Counsel.
- Sept. 18—Motion to transfer the motion to amend petition now set for 10/9/46, Washington, D. C., to the merit calendar of 11/4/46 at Los Angeles filed by taxpayer. 9/20/46 copy served.
- Oct. 9—Hearing had before Judge Turner on petitioner's motion to amend petition granted.
- Oct. 9—Order that petitioner's motion to amend petition filed 9/6/46 is granted, entered.
- Nov. 4—Hearing had before Judge Hill on merits. Motion of counsel to consolidate 7116 and 7117 granted. Motion of petitioner to file amendment to petition granted. Motion of respondent to file answer to amendment to petition and answer to pe-

tion as amended granted. Motion and amendment to petition, answer to amendment and answer to petition as amended filed at hearing, and served. Briefs due 12/23/46; replies due 1/22/47. [3]

1946

Dec. 17—Brief filed by taxpayer.

Dec. 18—Motion for extension to Jan. 23, 1947, to file brief and to 2/22/47 to file replies filed by General Counsel. 12/19/46 Granted.

1947

Jan. 6—Supplement to brief filed by taxpayer. 1/16/47 copy served.

Jan. 15—Brief filed by General Counsel.

Jan. 29—Reply brief filed by taxpayer. 1/29/47 copy served.

Feb. 7—One page addition to reply brief filed by taxpayer. 2/7/47 copy served.

Feb. 12—Reply brief filed by General Counsel.

Mar. 24—Memorandum findings of fact and opinion rendered. Judge Hill Decision will be entered under Rule 50. 2/24/47 copy served.

Apr. 28—Motion for extension of five days to file motion for rehearing filed by taxpayer. Granted.

Apr. 28—Motion for a rehearing filed by taxpayer. 4/29/47 Denied.

Apr. 29—Order amending memorandum findings of fact and denying petitioner's motion for rehearing, entered.

1947

- June 4—Respondent's computation for entry of decision filed.
- June 6—Hearing set July 16, 1947, Washington, D. C., on Rule 50.
- July 16—Hearing had before Judge Hill on settlement. No contest. Respondent's computation ordered to Judge Hill for order.
- July 17—Decision entered, Judge Hill, Div. 2.
- July 22—Order amending decision, entered.
- Oct. 17—Petition for review by U. S. Circuit Court of Appeals for the Ninth Circuit with assignments of error filed by taxpayer.
- Oct. 17—Proof of service filed.
- Nov. 24—Certified copy of an order from the Ninth Circuit for enlargement of 40 days to file transcript of record filed.
- Nov. 24—Certified copy of an order from the Ninth Circuit directing the Clerk of the Tax Court to transmit to the Clerk of the Circuit Court the original petitioner's exhibit 1 and respondent's exhibits A through K 15 days prior to the hearing before this Court filed.
- Nov. 25—Designation of record filed by taxpayer with proof of service thereon. [4]

The Tax Court of the United States
Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby petitions this court for a redetermination of his federal income tax liability for the taxable years ended December 31st, 1939, December 31, 1940, and December 31, 1941, as determined by the Commissioner of Internal Revenue in a notice of deficiency (Bureau symbols LA:IT:90D:PAK), and as a basis of this proceeding alleges as follows:

1. That the petitioner is an individual and that his address is 6200 Avalon Boulevard, Los Angeles 3, California; that he filed returns for the years involved herein with the Collector of the Sixth District of California; and that he kept his books and filed his returns on the accrual basis.

2. That a notice of deficiency, a copy of which marked Exhibit "A" is attached hereto, was mailed to the petitioner on November 17th, 1944.

3. That the deficiencies determined by the Commissioner were as follows:

1939—\$2,356.84

1940—\$5,225.29

1941—\$8,069.72; [5]

and that the amounts involved in this proceeding are:

1939—\$2,401.75

1940—\$5,397.79

1941—\$10,482.42

or such other amounts as the Court may determine.

4. That the determination of taxes as set forth in said notice of deficiency is based upon the following errors:

- (a) The treatment as ordinary income, instead of capital gain, of the gain derived by the petitioner under the so-called Gerrard contract of March 21, 1938.
- (b) The failure to allow, as an offset against the selling price in determining the amount of such gain, costs totaling \$111,500.
- (c) The failure to allow amounts totaling \$10,-500 payable and paid in each of the taxable years here involved as deductions under Sections 23(a)(2) of the Internal Revenue Code. (This is alternative to assignment of error (b).)
- (d) The failure to allow the full amount of California State income taxes accrued.

5. The facts upon which the petitioner relies as sustaining the above assignments of error are as follows:

A. With respect to assignment of error (a):

1. On or about March 21, 1938, the petitioner sold to The Gerrard Company, Inc. (hereinafter referred to as "Gerrard"), certain patents taken out

by him on flat wire tying machines and round wire tying machines, for a total consideration of \$425,000. Said patents were the community property of petitioner and his wife, Lena P. Harvey, and were all acquired after July, 1927. Of said patents, 7.292% in value were acquired not more than 18 months prior to said sale and 92.708%, more than 24 months prior to said sale.

2. Of said total consideration \$25,000 was payable and paid in cash upon execution of the sale; and the balance of \$400,000 was [6] payable and paid at the same time by delivery to petitioner of ten negotiable promissory notes in his favor in the sum of \$40,000 each, all dated April 2, 1938, and maturing serially beginning on the 2nd day of April, 1939, and on April 2 of each year thereafter, each of them in the form, with necessary variations as to dates and numbers, set forth in Exhibit "B" hereto attached and made a part hereof. The American Steel and Wire Company of New Jersey, shown in Exhibit "B" as joint maker, was the parent company of Gerrard.

3. Those of said notes of \$40,000 each which were due in the years involved herein were paid when due.

4. In filing his return for the year 1938, petitioner elected to return his gain from the said sale of patents on the installment basis under Section 44(b) of the Revenue Act of 1938 but otherwise he filed his return for the year 1938 on the accrual basis.

5. The said patents, both on flat wire tying machines and on round wire tying machines, were at the time of sale under exclusive license to Gerard. There were four such licenses, each covering a separate group of patents, as follows:

- (a) A license dated February 25, 1930, covering United States patents on flat wire tying machines, hereinafter referred to as "domestic flat band patents."
- (b) A license dated February 25, 1930, covering patents issued by foreign countries on flat wire tying machines, hereinafter referred to as "foreign flat band patents."
- (c) A license dated July 5, 1929, covering United States patents on so-called "TA" round wire tying machines, hereinafter referred to as "domestic round wire patents," together with an agreement under the same date giving in effect similar treatment to patents owned not by petitioner but by Gerard on so-called "TI" and "TE" round wire tying machines.
- (d) A license dated February 25, 1930, covering patents issued by foreign countries on so-called "TA" round wire tying [7] machines, hereinafter referred to as "foreign round wire patents."

Under date of October 12, 1936, an amendment of said license agreements was made and the payments to petitioner under the license agreements as so amended were guaranteed by the said American Steel and Wire Company of New Jersey.

6. Under the said licenses Gerrard had the sole and exclusive right for the entire life of said patents to use, lease and vend the machines covered by said patents, without obligation, however, to use, lease or vend any of them; and as a result of the said licenses, no substantial rights in the said patents remained to petitioner except the right to receive such minimum royalties as were provided under the licenses.

7. Under the said license of domestic flat band patents there was a minimum royalty payable by Gerrard to petitioner of \$15,000 per year; and under the said license of foreign flat band patents there was a minimum royalty payable by Gerrard to petitioner of \$15,000 per year. The said minimum royalty of \$15,000 per year under each license was payable as long as any patent covered by such license was unexpired. Among the patents covered by each license were patents issued as late as 1937.

8. On the date of sale of said patents, the right to receive said minimum royalty of \$15,000 per year under each of the two flat band licenses, or \$30,000 per year altogether, was in full force and effect and had a reasonable present value of \$425,000.

9. The round wire licenses carried no minimum royalties and the rights of petitioner under said round wire licenses and the [8] patents covered thereby had not more than a nominal value.

10. Petitioner was in the machine shop business manufacturing any kind of machines on order.

11. Petitioner was not a dealer in patents and was not in the business of selling patents.

12. None of said patents were stock in trade of petitioner.

13. None of said patents were other property of a kind which would properly be included in the inventory of the petitioner if on hand at the close of the taxable year.

14. None of said patents were held by petitioner primarily for sale to customers in the ordinary course of his trade or business.

15. No patents of any kind were ever held by petitioner primarily for sale to customers in the ordinary course of his trade or business.

16. Gerrard was not a customer for said patents in the ordinary course of petitioner's trade or business.

17. Said sale of patents was not made by petitioner in the ordinary course of his trade or business.

18. The said flat band patents were not used in petitioner's trade or business.

19. Only experimental models of the flat band machines were ever manufactured by petitioner; and insofar as petitioner knows, none were ever manufactured or sold by Gerrard.

20. Under the said licenses of flat band patents the only royalties ever received by petitioner were the minimum royalties provided for thereunder.

B. With respect to assignment of error (b):

1. In connection with the said patents and the

sale thereof, petitioner incurred costs totaling \$111,500 as shown by Exhibit "C" attached hereto which is a copy of Exhibit B and Exhibit B-1 of the report dated January 29, 1940, of George D. Martin, Internal Revenue Agent in Charge, Los Angeles, California, on the examination by his office of the return of petitioner for the year 1938.

2. The statements made in said Exhibit "C" under items (b) and (c) thereof are explanatory, respectively, of the amounts of \$85,000 and \$26,500 shown in the computation in said exhibit as payments due Lawrence A. Harvey and Herbert Harvey. Said statements are correct except that (1) the sale of said patents was to Gerrard only and not to Gerrard and the American Steel & Wire Company, although both companies were makers on the ten notes received by petitioner totaling \$400,000 out of the aggregate consideration of \$425,000, and (2) that the services of Lawrence A. Harvey included also aid and assistance in the negotiation of the said sale of patents.

3. Because of said costs totaling \$111,500, only $313,500/425,000$, or 73.7647%, of each payment of \$40,000, or \$29,505.88, is the amount of gain derived from said sale of patents applicable to each of the years here involved; of said \$29,505.88, 7.292% (see exhibit "C") or \$2,151.57 is includible in gross income at 100% and the balance of \$27,354.31 at 50% under Section 117(b) of the Internal Revenue Code; and that the amount so includible in gross income is one-half his and one-half

that of his wife, Lena P. Harvey, by virtue of the community property laws of California. [10]

C. With respect to assignment of error (c):

1. Of the payments shown in Exhibit "C" as due Lawrence A. Harvey in the total amount of \$85,000, or 20% of the said consideration of \$425,000, \$5,000 was payable and paid in 1938 and the balance of \$80,000 was payable pro rata as and when the said notes totaling \$400,000 were paid to petitioner. Of said balance of \$80,000, \$8,000 was accordingly payable and paid by petitioner to said Lawrence A. Harvey in each of the years here involved.

2. Of the payments shown in Exhibit "C" as due Herbert Harvey in the total amount of \$26,500, \$1,500 was payable and paid in 1938 and the balance of \$25,000 was payable pro rata as and when the said notes totaling \$400,000 were paid to petitioner. Of said balance of \$25,000, \$2,500 was accordingly payable and paid by petitioner to said Herbert Harvey in each of the taxable years here involved.

D. With respect to assignment of error (d):

1. Additional income taxes have been asserted against petitioner by the Franchise Tax Commissioner of the State of California as follows:

1939\$	642.88
1940	1,034.82
1941	4,618.61

2. The amounts allowed by the Commissioner as additional California income taxes for the same years as shown in Exhibit "A" attached hereto rep-

resented the additional California income taxes payable if petitioner is correct with respect to assignment of error (a) and assignment of error (b). The additional California income taxes payable are, however, \$642.88, \$1,034.82 and \$4,618.61 for the respective years if petitioner is correct with respect to assignment [11] of error (b) but not with respect to assignment of error (a). No determination has yet been made by the Franchise Tax Commissioner as to the additional state income taxes which will be due on any other assumption with respect to assignments of error (a), (b) and (c).

Wherefore, petitioner prays that the Court:

- (a) Redetermine the taxes of petitioner for the years 1939, 1940 and 1941;
- (b) Determine that there is no deficiency due by this petitioner; and
- (c) Determine that the petitioner has overpaid his tax for the years 1939, 1940 and 1941.

/s/ GEORGE T. ALTMAN,

Attorney for Petitioner. [12]

State of California,
County of Los Angeles—ss.

Leo M. Harvey, being duly sworn, deposes and says: That he is the petitioner above named; that he has read the foregoing petition, and is familiar with the statements contained herein, and that the facts therein stated are true.

/s/ LEO M. HARVEY.

Subscribed and sworn to before me this 8th day of February, 1945.

[Seal] /s/ ALICE E. WIEDER,

Notary Public in and for said
County and State.

My Commission expires July 1, 1947. [13]

EXHIBIT "A"

Treasury Department, Internal Revenue Service
417 South Hill Street, Los Angeles 13, California

Nov. 17, 1944.

Office of Internal Revenue Agent in Charge, Los
Angeles Division, LA:IT:90D:PAK.

Mr. Leo M. Harvey
6200 Avalon Boulevard
Los Angeles 3, California.

Dear Mr. Harvey:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1939, December 31, 1940 and December 31, 1941, discloses a deficiency of \$15,651.84, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby give of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,

Commissioner,

By /s/ GEORGE D. MARTIN,

Internal Revenue Agent
in Charge.

PAK:vac

Enclosures:

Statement

Form of waiver [14]

STATEMENT

LA:IT:90D:PAK

Mr. Leo M. Harvey

6200 Avalon Boulevard

Los Angeles 3, California

Tax Liability for the Taxable Years Ended

December 31, 1939, December 31, 1940 and December 31, 1941

Years	Liability	Assessed	Deficiency
1939	\$ 3,926.10	\$ 1,569.27	\$ 2,356.83
1940	12,331.96	7,106.67	5,225.29
1941	47,854.45	39,784.73	8,069.72
Totals	<u>\$64,112.51</u>	<u>\$48,460.67</u>	<u>\$15,651.84</u>

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated August 5, 1943, to your protest dated January 4, 1944, and to the statements made at conferences held on January 21, June 6, July 6 and July 27, 1944.

In your income tax returns for each of the years 1939, 1940 and 1941 you reported community income received under the so-called "Gerrard Contract" of March 21, 1938, as follows:

	Total Gain	Sec. 117 Limitation	Community Share Reported
Short-term capital gain.....	\$ 2,151.57	\$ 2,151.57	\$1,075.79
Long-term capital gain.....	27,354.31	13,677.15	6,838.58

It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income. Your community share of this income has accordingly been increased in each year by the amount of \$12,085.63 from the \$7,914.37 (total reported as above) to \$20,000.00.

A copy of this letter and statement has been mailed to your representative, Mr. George T. Altman, 215 West Seventh Street, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1939

Net income as disclosed by return.....		\$ 9,059.36
Additional income and unallowable deductions:		
(a) Increase in income from Ger-rard contract	\$12,085.63	
(b) Increase in partnership income	9,849.10	21,934.73
	<hr/>	<hr/>
Total.....		\$30,994.09
Additional deduction:		
(c) Additional California income tax allowed		299.43
		<hr/>
Net income adjusted.....		\$30,694.66

Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$9,849.10 to the income reported on your return from the partnership, Harvey Machine Co.

(c) A deduction for additional accrued California income tax is allowed in the amount of \$299.43.

COMPUTATION OF TAX

Taxable Year Ended December 31, 1939

Net income adjusted.....		\$30,694.66
Less: Personal exemption	\$ 666.67	
Credit for dependents.....	1,166.67	1,833.34
	<hr/>	<hr/>
Balance surtax net income.....		\$28,861.32
Less: Earned income credit.....		300.00
		<hr/>
Balance subject to normal tax.....		\$28,561.32
Normal tax at 4% of \$28,561.32.....	\$ 1,142.45	
Surtax on \$28,861.32.....	2,783.65	
	<hr/>	<hr/>
Correct income tax liability.....		\$ 3,926.10
Income tax assessed:		
Original, account No. 202699.....	\$ 418.34	
Additional, December 31, 1943, No. 519016	1,150.93	1,569.27
	<hr/>	<hr/>
Deficiency of income tax.....		\$ 2,356.83

ADJUSTMENTS TO NET INCOME

Taxable Ended December 31, 1940

Net income as disclosed by return.....		\$25,509.17
Additional income and unallowable deductions:		
(a) Increase in income from Gerrard contract	\$12,085.63	
(b) Increase in partnership income	7,894.35	
(c) Additional rental income.....	269.98	
(d) Bad debts disallowed.....	414.82	20,664.78
	<hr/>	<hr/>
Total		\$46,173.95
Additional deduction:		
(e) Additional California income tax allowed		505.87
		<hr/>
Net income adjusted.....		\$45,668.08

Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$7,894.35 to the income reported on your return from the partnership, Harvey Machine Co.

(c) Income from rentals is increased by \$269.98 representing your community one-half of rental income from the Webster Apartments not included in income on your return.

(d) Bad debts aggregating \$829.64 have been disallowed as a deduction under section 23(k) of the Internal Revenue Code. One-half of that amount, or \$414.82, is applicable to your return.

(e) A deduction is allowed for additional accrued California income tax in the amount of \$505.87.

The earned income credit claimed in your return in the amount of \$816.13 is reduced to \$565.95, the amount allowable under section 25 (a) (4) of the Internal Revenue Code.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1940

Net income adjusted.....			\$45,668.08
Minus: Net long-term capital gain.....			174.60
			<hr/>
Ordinary net income.....			\$45,493.48
Less: Personal exemption.....	\$	600.00	
Credit for dependents.....		800.00	1,400.00
			<hr/>
Balance (surtax net income).....			\$44,093.48
Less: Earned income credit.....			565.95
			<hr/>
Net income subject to normal tax.....			\$43,527.53
Normal tax at 4% on.....	\$43,527.53	\$	1,741.10
Surtax on	\$44,093.48		9,417.39
			<hr/>
Partial tax.....			\$11,158.49
Plus: 30% of net long-term capital gain.....			52.38
			<hr/>
Alternative tax			\$11,210.87

COMPUTATION OF TAX

Taxable Year Ended December 31, 1940

Net income adjusted.....			\$45,668.08
Less: Personal exemption	\$	600.00	
Credit for dependents.....		800.00	1,400.00
			<hr/>
Balance (surtax net income).....			\$44,268.08
Less: Earned income credit.....			565.95
			<hr/>
Net income subject to normal tax.....			\$43,702.13
Normal tax at 4% on.....	\$43,702.13	\$	1,748.09
Surtax on	\$44,268.08		9,487.23
			<hr/>
Total			\$11,235.32
Alternative tax			\$11,210.87
Defense tax (10% of \$11,210.87).....			1,121.09
			<hr/>
Correct income tax liability.....			\$12,331.96

Income tax assessed:

Original, account No. 205761.....	\$ 4,247.32
Additional, December 31, 1943	
No. 519017	2,859.35

Total income tax assessed.....	7,106.67
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Deficiency of income tax.....	\$ 5,225.29
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ADJUSTMENTS TO NET INCOME

Taxable Year Ended December 31, 1941

Net income as disclosed by return.....	\$48,967.08
--	-------------

Additional income:

(a) Increase in income from Gerrard contract.....	\$12,085.63	
(b) Increase in partnership in- come	37,428.30	\$49,513.93

Total	\$98,481.01
-------------	-------------

Additional deductions:

(c) Dividends received over- stated	\$ 17.16	
(d) Long-term capital gain re- duced	1,904.19	
(e) Additional California in- come tax allowed.....	3,711.84	5,633.19

Net income adjusted.....	\$92,847.82
--------------------------	-------------

Explanation of Adjustments

(a) This adjustment has been previously explained.

(b) There has been added the amount of \$37,428.30 to the income reported on your return from the partnership, Harvey Machine Co.

(c) Dividends received were overstated by the amount of \$15.05 from Harcraft Co. and \$19.27 from U. S. National Bank. One-half of those amounts or \$17.16 is applicable to your return.

(d) In your return you reported a long-term capital gain of \$1,904.19 representing your community half of a total long-term capital gain of \$3,808.38 from the sale of cup machines, patents and equipment. It has been determined that this income constitutes income to the partnership, Harvey Machine Co., and is

included in the adjustment of partnership income under item (b) above. The long-term capital gain reported in your return from this sale is, accordingly, eliminated.

(e) A deduction for additional accrued California income tax is allowed in the amount of \$3,711.84.

COMPUTATION OF ALTERNATIVE TAX

Taxable Year Ended December 31, 1941

Net income adjusted.....			\$92,847.82
Minus: Net long-term capital gain.....			589.66
			<hr/>
Ordinary net income			\$92,258.16
Less: Personal exemption	\$	350.00	
Credit for dependents.....		800.00	1,150.00
			<hr/>
Balance (surtax net income).....			\$91,108.16
Less: Earned income credit.....			1,400.00
Net income subject to normal tax.....			\$89,708.16
Normal tax at 4% on.....	\$89,708.16	\$	3,588.33
Surtax on	91,108.16		44,089.22
Partial tax			\$47,677.55
Plus: 30% of net long-term capital gain.....			176.90
			<hr/>
Alternative tax			\$47,854.45

COMPUTATION OF TAX

Taxable Year Ended December 31, 1941

Net income adjusted.....			\$92,847.82
Less: Personal exemption	\$	350.00	
Credit for dependents.....		800.00	1,150.00
			<hr/>
Balance (surtax net income).....			\$91,697.82
Less: Earned income credit.....			1,400.00
			<hr/>
Net income subject to normal tax.....			\$90,297.82
Normal tax at 4% on.....	\$90,297.82	\$	3,611.91
Surtax on.....	91,697.82		44,466.60
			<hr/>
Total			\$48,078.51
Alternative tax			\$47,854.45
Correct income tax liability.....			\$47,854.45

Income tax assessed:

Original, account No. 340838..... \$20,036.07

Additional, December 31, 1943

No. 519018 19,748.66

Total income tax assessed..... 39,784.73

Deficiency of income tax..... \$ 8,069.72

EXHIBIT B

Cleveland, Ohio

Dated April 2, 1938.

Note No. 1 Due April 2, 1939

Twelve (12) months after date, we jointly and severally promise to pay to the order of Leo M. Harvey the sum of Forty Thousand Dollars (\$40,000.00) together with interest at the rate of two per cent (2%) per annum, without defalcation, for value received. Interest payable quarterly. The drawers and endorsers, severally waive presentment for payment, demand, protest, notice of protest and dishonor and non-payment, of this note. Payable at Union Bank & Trust Co. of Los Angeles.

This note is one of a series of notes made by the same makers to the same payee in the same amount numbered one to ten inclusive, each dated April 2, 1938, No. 1 being payable April 2, 1939, No. 2, April 2, 1940, No. 3, April 2, 1941, No. 4, April 2, 1942, No. 5, April 2, 1943, No. 6, April 2, 1944, No. 7, April 2, 1945; No. 8, April 2, 1946, No. 9, April 2, 1947, and No. 10, April 2, 1948.

Upon default in the payment of principal or interest of any one of the above enumerated notes, one to ten inclusive, any and/or all of the said notes from one to ten inclusive, shall at the option of the holders thereof become immediately due and payable, together with costs of collection, including such reasonable attorney's [22] fees as a court of competent jurisdiction may determine.

THE GERRARD COMPANY,
INC., a Delaware Corporation

By
Executive Vice President.

By
Assistant Secretary.

[Seal] THE AMERICAN STEEL AND
WIRE COMPANY OF NEW
JERSEY

By
President.

Attest:

.....
Treasurer and Secretary.

L.M.H.:W.B.

EXHIBIT C

INSTALLMENT PROFITS REALIZED

In re: Sale of Patents

Total sale price.....		\$425,000.00
Less: Cost of patents.....	None	
Payments due Lawrence A.		
Harvey	\$85,000.00	
Payments due Herbert		
Harvey	26,500.00	111,500.00
Net profit to be realized.....		313,500.00
Profit percentage		73.7647%
Installment payment received—Year 1938.....		\$ 25,000.00

	Short Term	Long Term	Total
Sales allocation	7.292%	92.708%	100%
Profit allocation at			
73.7647%	\$1,344.73	\$17,096.45	\$ 18,441.18
Taxable at	100%	50%	
Taxable profits.....	1,344.73	8,548.23	
Profits reported.....	1,713.62	10,893.19	
Profits corrected.....	1,344.73	8,548.23	
Net reductions.....	\$ 368.89	\$ 2,344.96	

Explanation of Items

(a) Major portion of the patents sold were about ten years old; no cost data capitalized, and none claimed.

(b) Represents 20% of the total sales price, payable to Lawrence A. Harvey, who is an attorney, for legal services, etc., in connection with patent research work, drawing up sales contracts covering the various patents, both domestic and foreign, prior to sale of taxpayer's patents to The Gerrard Co., Inc., and the American Steel and Wire Company.

(c) Represents amount payable to Herbert Harvey for engineering and mechanical work and assistance during prior years in the development of the various patents; it is a verbal agreement.

[Endorsed]: Received and filed Feb. 12, 1945.

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that there are in controversy income tax deficiencies for the taxable years ended December 31, 1939, 1940 and 1941; denies the remaining allegations contained in paragraph 3 of the petition.

4. (a) to (d), inclusive. Denies the allegations of error contained in all subparagraphs, (a) to (d), inclusive, of paragraph 4 of the petition. [25]

5. (A)(1) Admits the allegations contained in the first sentence and denies the remaining allegations of subparagraph (A)(1) of paragraph 5 of the petition.

(A)(2) to (A)(4), inclusive. Admits the allegations contained in subparagraphs (A)(2) to (A)(4), inclusive, of paragraph 5 of the petition.

(A)(5) For lack of sufficient information to form a conclusion as to the truth and correctness of the allegations contained in subparagraph (A)(5) of paragraph 5 of the petition, respondent denies said allegations.

(A)(6) to (A)(20), inclusive. Denies the allegations contained in subparagraphs (A)(6) to (A)(20), inclusive, of paragraph 5 of the petition.

(B)(1) to (B)(3), inclusive. Denies the allegations contained in subparagraphs (B)(1) to (B)(3), inclusive, of paragraph 5 of the petition.

(C)(1) and (C)(2) Denies the allegations contained in subparagraphs (C)(1) and (C)(2) of paragraph 5 of the petition. [26]

(D)(1) and (D)(2). Denies the allegations contained in subparagraphs (D)(1) and (D)(2) of paragraph 5 of the petition.

6. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

E. C. CROUTER,

Special Attorney,

Bureau of Internal Revenue.

ECC/ve 3/12/45

[Endorsed]: Received and filed March 19, 1945.

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

MOTION TO AMEND PETITIONS

Petitioners move the court for leave to amend their respective petitions by addition of the following paragraph preceding the prayer of each petition:

“6. Because of the election of accelerated amortization under Section 124(d) of the Internal Revenue Code by Harmac Co., a copartnership, in which Leo M. Harvey has a two-thirds interest, petitioner requests a finding for additional overpayment in the amount of \$322.22 for 1941.”

Petitioners further move that this motion be deemed such amendment. [28]

Reason for Motion

The recomputation of the amortization of emergency facilities in the case of the said Harmac Co. for 1941 is shown on the statement attached hereto. As there shown, there is a resulting reduction of the net income of petitioner in the amount of \$495.72 for that year. The effect upon the tax is a reduction therein in the amount of \$322.22.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioner, 215 West 7th Street, Los
Angeles 14, California. [29]

State of California,
County of Los Angeles—ss.

Leo M. Harvey, being duly sworn, deposes and says: That he is one of the petitioners above named; that he has read the foregoing motion and is familiar with the statements contained therein, and that the facts therein stated are true.

/s/ LEO M. HARVEY.

Subscribed and sworn to before me this 26th day of August, 1946.

[Notary Seal]

/s/ WILLIAM S. PEARSON,
Notary Public in and for said
County and State.

My Commission Expires June 30, 1950.

State of California,
County of Los Angeles—ss.

Lena P. Harvey, being duly sworn, deposes and says: That she is one of the petitioners above named; that she has read the foregoing motion and is familiar with the statements contained therein, and that the facts therein stated are true.

/s/ LENA P. HARVEY.

Subscribed and sworn to before me this 26th day of August, 1946.

[Notary Seal]

/s/ WILLIAM S. PEARSON,

Notary Public in and for said
County and State.

My Commission Expires June 30, 1950. [30]

RECOMPUTATION OF AMORTIZATION OF EMERGENCY FACILITIES OF HARMAC CO. FOR
1941 UNDER INTERNAL REVENUE CODE, SECTION 124(d)

Item	Date Acquired	Cost	Depreciation or Amortization	
			Taken	Sec. 124(d)
Hand Mill	March, 1941	\$ 180.25	\$ 27.14	\$ 30.04
Press	June, 1941	24,795.05	1,570.06	2,917.06
Power Press Brake	November, 1941	1,163.90	19.36	25.30
Press Brake Machine	April, 1942	7,458.05	994.43	1,125.74
			<hr/>	<hr/>
			\$2,610.99	\$4,098.14
			<hr/>	<hr/>
Deduct amortization taken				2,610.99
				<hr/>

Increases in amortization by virtue of election under sec. 124(d)
of amortization period ended with the month of September,
1945

\$1,487.15

Leo M. Harvey partnership interest in Harmac Co.— $\frac{2}{3}$ rds;
therefore $\frac{2}{3}$ rds of above amount

\$ 991.44

Community division: Leo M. Harvey— $\frac{1}{2}$

\$ 495.72

Lena P. Harvey— $\frac{1}{2}$

\$ 495.72

[Endorsed]: Received and Filed Sept. 6.

[Title of Tax Court and Cause.]

ORDER

These proceedings came on for hearing on October 9, 1946, at Washington, D. C., on petitioner's motion to amend petitions. Counsel for the respondent offered no objection thereto. After due consideration, it is

Ordered: That petitioner's motion to amend petitions, filed on September 6, 1946, is granted.

[Seal] /s/ BOLON B. TURNER,
Judge.

Dated October 9, 1946, Washington, D. C. [32]

[Title of Tax Court and Cause.]

MOTION

Petitioners move the Court for leave to amend their respective petitions as follows:

1. The last sentence of subparagraph 1 of paragraph 5-A is amended to read as follows:

“All of said patents were acquired more than 24 months prior to the date of said sale.”

2. After subparagraph 20 of paragraph 5-A, the following subparagraphs are added:

“21. The notes totalling \$400,000 referred to in subparagraph 2 above had a fair market value of \$400,000 at the time received by petitioner Leo M. Harvey.” [33]

“22. Said petitioner at no time was a person who regularly sells or otherwise disposes of property on the installment plan.”

Petitioners further move the Court that this motion be deemed the amendment of the petitions.

Dated Los Angeles, California, November 4th, 1946.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioners, 215 West 7th Street, Los
Angeles 14, California.

Granted Nov. 4, 1946.

/s/ SAMUEL B. HILL,
Judge.

[Endorsed]: Filed Nov. 4, 1946.

Copy served. [34]

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ANSWER TO PETITION AS AMENDED

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal

Revenue, and denies all the allegations contained in paragraph 6 of the petition as amended.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,

Division Counsel.

EARL C. CROUTER,

E. A. TONJES,

Special Attorneys,

Bureau of Internal Revenue.

EAT/ftc 11/4/46

[Endorsed]: Filed Nov. 8, 1946. [35]

[Title of Tax Court and Cause.]

ANSWER TO AMENDMENT TO PETITION

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the amendment to the petition of the above-named taxpayer, admits and denies as follows:

1. Denies the amendment to the last sentence of subparagraph 1 of paragraph 5-A of the petition, reading as follows:

“All of said patents were acquired more than 24 months prior to the date of said sale.”

2. Denies the allegations contained in subparagraphs 21 and 22 of paragraph 5-A of the petition, as amended.

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel.
EARL C. CROUTER,
E. A. TONJES,
Special Attorneys,
Bureau of Internal Revenue.

EAT/mmb 11/6/46.

[Endorsed]: Filed Nov. 8, 1946.

Copy served. [36]

[Title of Tax Court and Cause.]

MOTION FOR JUDGMENT ON THE
PLEADINGS

Petitioner moves the Court for judgment on the pleadings.

If this motion is placed upon the calendar for argument, petitioner requests that it be so placed upon the Los Angeles calendar if that is possible.

Reason for Motion

In subparagraph (A)(4) of paragraph 5 of the petition, petitioner alleged that in filing his return for 1938 he elected to return his gain from a certain sale of patents on the installment basis under Section 44(b) of the Revenue Act of 1938 but otherwise filed his return for 1938 on the accrual basis. Respondent in his answer has admitted this allegation.

Respondent, however, has denied all of petitioner's allegations contained in subparagraphs (A)(6) to (A)(20), inclusive, of paragraph 5 of the petition. If any one of the allegations in paragraphs (A)(11) to (A)(17), inclusive, of paragraph 5 of the petition is untrue, then petitioner had no right to make the installment election referred to above and no part of the income from said sale is includable in the [37] gross income of petitioner for any of the years involved in this proceeding. Petitioner asks for judgment on the pleadings based upon that conclusion.

Petitioner desires to make it clear for the purpose of the record that he is not maintaining the position that any of the allegations made by him in paragraphs (A)(11) to (A)(17), inclusive, of subparagraph 5 of the petition is untrue. On the contrary he reaffirms the truth of said allegations. The conclusion stated above that no part of the income from said sale of patents should be included in gross income of petitioner for the years herein involved is merely a necessary corollary of the position taken by respondent. The position maintained by peti-

tioner remains the same as stated in his petition and petitioner now and hereby reaffirms that position.

Wherefore, it is prayed that this motion for judgment on the pleadings be granted.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioner, 215 West 7th Street, Los
Angeles 14, California.

Dated Los Angeles, California, March 28th, 1945.

[Endorsed]: Received and filed April 2, 1945.

Denied May 17, 1945.

/s/ J. E. MURDOCK,
Judge.

Copies served on both parties. [38]

The Tax Court of the United States

Docket Nos. 7116, 7117

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

George T. Altman, Esq., for the petitioners.

E. A. Tonjes, Esq., for the respondent.

MEMORANDUM FINDINGS OF FACT
AND OPINION

Hill, Judge: Respondent determined deficiencies in petitioner's income tax as follows:

Docket No.	1939	1940	1941
7116 Leo M. Harvey	\$2,356.83	\$5,225.29	\$8,069.72
7117 Lena P. Harvey	2,356.84	5,225.29	8,069.72

The questions are (1) whether the gain realized by petitioners on account of the installment sale of certain patents constituted capital or [39] ordinary gain, and (2) whether certain percentages of the sales price paid by petitioners to others can properly be excluded or deducted by petitioners

from the sales price received by them. Petitioners filed separate returns for the taxable years with the collector of internal revenue for the sixth district of California at Los Angeles on a community and accrual basis. The cases were consolidated for hearing.

FINDINGS OF FACT

Petitioners are husband and wife residing in Los Angeles. Unless otherwise indicated petitioner will hereinafter refer to petitioner Leo M. Harvey.

By written agreement dated March 21, 1938, petitioner sold certain patents and applications for patents, both foreign and domestic, to the Gerrard Company, Inc., hereinafter referred to as Gerrard. The patents so sold by petitioner covered inventions in the round wire tying and the flat band strapping and tying fields. As here material, Gerrard paid petitioner as consideration \$25,000 cash upon execution of the agreement and delivered to petitioner 10 negotiable promissory notes, each in the amount and each having then a fair market value of \$40,000, all dated April 2, 1938, numbered 1 to 10, inclusive, and maturing serially commencing April 2, 1939, and thereafter on April 2 of each succeeding year through April 2, 1948. These notes were tendered and accepted as payment. During the taxable years here involved these notes were paid when due.

By written agreement and under circumstances hereinafter described petitioner paid his son Lawrence 20 per cent of the proceeds of the sale as received by petitioner. Petitioner also paid certain

amounts to his brother Herbert from such proceeds. Herbert was thus paid \$2,500 in each of the taxable years here involved. [40]

In reporting the proceeds of the sale for income tax purposes petitioners excluded or deducted from the sales price certain amounts on account of such obligations or payments to Lawrence and Herbert. The remainder of the sales price was reported on the installment basis and treated as capital gain, each petitioner reporting a community one-half. Thus, petitioners reported as taxable gain to be taken into account from the sale the amount of \$15,828.72 for each of the taxable years here involved, each petitioner reporting a community half thereof, or \$7,914.37.¹ Respondent determined that the entire proceeds received constituted ordinary income to petitioners and not capital gain. Respondent in this connection stated:

It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income. Your community share of this income has accordingly been increased in each year by the amount of \$2,085.63 from the \$7,914.37 (total reported as above) to \$20,000.00.

Petitioner's son, Lawrence, was an attorney about 28 years old in 1938. He assisted petitioner in negotiating the sales contract with Gerrard. Petitioner agreed in writing dated April 2, 1938, to compen-

¹The figure of \$7,914.37 was the one actually reported rather than \$7,914.36.

sate Lawrence for his efforts in this connection by paying him 20 per cent of all proceeds of the sale as received by petitioner. Under this agreement petitioner paid Lawrence \$8,000 a year during the taxable years. Petitioner also employed as attorneys in connection with the Gerrard deal, Max Schlesinger, who handled the tax aspects, one Rubin and a Walter Sheldon. Walter Sheldon was paid \$22,500 in 1938 by petitioner for his services, which services among others concluded Sheldon's work in connection with the Gerrard sale. [41]

Petitioner's brother, Herbert, had been an employee of petitioner since about 1918 on a salary ranging from \$500 to \$1,500 a month. Petitioner, since about 1914, had been sole proprietor of a business known as Harvey Machine Company. This business consisted primarily of making industrial machinery on special order. Herbert was employed in connection with this business.

Petitioner with the advice and assistance of Herbert had commenced developing inventions in the wire tying field in the middle 1920's and subsequent thereto and from time to time obtained the patents sold to Gerrard. The expense of developing these inventions were deducted as business expenses of Harvey Machine Company. Some time in 1930 petitioner licensed Gerrard to operate under certain of the flat wire tying patents at a minimum royalty of \$30,000 a year, which petitioner received from 1931 to 1937, inclusive. In 1938 and by the terms of the sales contract Gerrard agreed to pay petitioner certain amounts on account of royalties due

up to and including March 31, 1938. These royalty payments were reported by petitioner as income from the business of Harvey Machine Company. Petitioner had paid Herbert 10 per cent of the \$30,000 annual minimum royalty received by petitioner from Gerrard. The sales contract with Gerrard stated that it was understood between the parties that the patents involved and referred to as owned by petitioner included not only those owned by petitioner but "also patents, patent applications and inventions, if any, owned by Herbert Harvey * * *." [42]

OPINION

While it may be doubtful whether the patents involved constituted petitioner's stock in trade or property of a kind which would properly be included in inventory or property held primarily for sale to customers in the ordinary course of business, we think it is clear that such patents constituted property used in the trade or business of a character which is subject to the allowance of depreciation. Such patents did not, therefore, constitute capital assets within the meaning of section 117 (a) of the Internal Revenue Code, and the gain from their sale was ordinary income and not subject to the percentage limitations of section 117 (b).

The development and patenting of the inventions and the licensing appears to us a normal, logical and natural phase of petitioner's business of machinist. The expenses of developing the inventions were deducted as business expenses and the royal-

ties were treated as income of the business. Petitioner received a minimum royalty of \$30,000 a year for at least seven years or a total of \$210,000 before their final sale for \$425,000. It is impossible for us to consider petitioner's income-producing activities in connection with these patents as a mere hobby or recreation or as an isolated or casual affair such as to characterize them in terms other than those connotating business use. We are satisfied that the record supports the conclusion that petitioner used the patents in his business. That such patents, under the circumstances, were subject to the allowance for depreciation provided in section 23 (1) seems sufficiently apparent as to require no discussion.

Petitioner argues that the patent activities had no connection with [43] his business which was making machines on special order. Petitioner further argues that the mere passive role of receiving royalties can not be considered a business. We think these arguments subject the facts to a strained and unnatural interpretation. We can see no reason or necessity for limiting the scope of petitioner's business carried on in the name of Harvey Machine Company to the making of machinery on special order and excluding therefrom the inventive activity that did in fact co-exist in the making of machinery. The expenses of this inventive activity were deducted as a business expense of Harvey Machine Company and the royalty income was included as income of the Harvey Machine Company.

Nor do we consider it realistic to look only at the receipt of royalties divorced from the efforts and accomplishments leading up to such receipt and to say such passive receipt does not constitute a business. We conclude therefore that the patents in question were used by petitioner in his business and were subject to depreciation. It follows that they were not capital assets and that the gain from their sale constituted ordinary income as respondent determined.

Petitioner does not contend that Lawrence had an interest in the patents but does contend that the 20 per cent of the sales price paid to Lawrence constituted a necessary expense of the sale. Inter-family transactions inevitably invite special scrutiny and in the instant case we are not satisfied and do not think petitioner has sufficiently established the nature and value of Lawrence's services. Lawrence was an attorney and did render some assistance to his father but other lawyers were also on hand and we know that at least one of them received very substantial payments for his services. The amount of \$85,000 [44] promised Lawrence seems to us an almost incredible fee for the nebulous services described in the record. We can not but believe that Lawrence's filial status more than his services were determinative. Lawrence did not testify at the hearing. We have only petitioner's very vague recitations as to his son's services. Under these circumstances we must conclude that petitioner has failed to sustain the burden of proof. It follows

that respondent's determination in this connection must be sustained.

Petitioner paid certain amounts of the sales price to Herbert, his brother. In this connection petitioner argues that Herbert had an interest in the patents and that the amounts paid him constituted payments for such interest. There is no evidence in the record supporting the conclusion that Herbert had a property interest in the patents. Herbert assisted petitioner in his work on the inventions and his advice was invaluable to petitioner. Petitioner paid him a salary as an employee and further paid him a percentage of the royalties but there is nothing to indicate that such percentage was not merely a manner of compensating Herbert for his services in addition to his regular salary. So far as we can determine none of the patents was in Herbert's name nor is there anything in the record to indicate that petitioner had been or was under any legal obligation either to pay Herbert a percentage of the royalties or a percentage of the sales price. The sales contract, it is true, states that the patents subject to the sale are intended to include those, if any, owned by Herbert but this statement is far from proof that Herbert had in fact any interest or that petitioner was obliged to compensate him for any such interest. Under these circumstances we think petitioner has failed to establish the payments to Herbert as [45] either exclusions or deductions from the sales price. It follows that respondent's determination in this connection must also be sustained.

With respect to the question of accelerated amortization petitioner has agreed to abide by respondent's adjustments thereof. In the petition petitioner raised a question concerning the proper amount deductible on account of California franchise taxes. This question was not discussed by either party on brief. Since the determination of this Court with respect to petitioner's liability for Federal income taxes affects the amount of the franchise tax due the State of California the proper amount deductible for such taxes can be determined under a Rule 50 computation.

Decisions will be entered under Rule 50.

[Entered]: Mar. 24, 1947.

[Seal] [46]

[Title of Tax Court and Cause.]

MOTION FOR A REHEARING

Petitioners move the court for a rehearing and as a basis therefor state as follows:

1. The findings of fact are directly contradictory to the evidence. The court, for example, states:

“In 1938 and by the terms of the sales contract Gerrard agreed to pay petitioner certain amounts on account of royalties due up to and including March 31, 1938. These royalty payments were reported by petitioner as income from the business of Harvey Machine Company.”

As Respondent's Exhibit "H" clearly shows, the said royalty payments were reported by petitioner on line 7 of his return for that year and were not reported by him as income from the business of Harvey Machine Co. or as income from any other business; nor does the said return disclose any income of any kind from a business owned by Leo M. Harvey as individual.

2. The court states in its opinion that Lawrence Harvey did not testify at the hearing. Petitioners believe this is prejudicial. The only reason why petitioners did not call him to testify was that petitioners believed and still believe that only the bona fides of the compensation and not the value of the services was involved. In [47] view of the court's consideration of the question of value and its implied rejection of the view that that question is not pertinent in connection with a capital expenditure, petitioners desire now to call Lawrence A. Harvey as a witness for the purpose of showing the value of his services. To this end, petitioners state that if Lawrence A. Harvey is called as a witness, he will testify in substance as shown in the affidavit attached hereto as Exhibit "A".

3. The court, while agreeing that Lawrence Harvey did render services to Leo M. Harvey "in negotiating the sales contract with Gerrard", and while predicating its decision in respect thereto on the question of value, failed to place any value on the said services. Petitioners submit that this is a clear error of law and that it is the duty of this court to determine the value of said services where

in its opinion their value is in issue and the value placed upon them by petitioners was too high.

4. The court has given no consideration as evidence to the payments by Leo M. Harvey to Herbert Harvey of 10% of the \$30,000 annual minimum royalty. Petitioners submit that such payments were clear evidence of an agreement between the parties entitling Herbert to a percentage of the proceeds from the patents, and that the conclusions of the court in respect thereto are in conflict with the evidence. For the purpose only of avoiding any implication that might have resulted from the fact that Herbert Harvey was not called as a witness petitioners now desire to call him as a witness. If Herbert Harvey is called as [48] a witness he will testify in substance as shown in the affidavit attached hereto as Exhibit "B".

Petitioners further pray the court that this motion be not denied without a hearing thereon. Petitioners state in that connection that their counsel will not, because of school engagements, be able to appear in Washington before June 15th.

Wherefore, petitioners pray that this motion be granted.

/s/ GEORGE T. ALTMAN,

Attorney for Petitioners.

215 West 7th Street,

Los Angeles 14, California.

EXHIBIT "A"

AFFIDAVIT

State of Illinois,
County of Cook—ss.

Lawrence A. Harvey, of the County of Los Angeles, State of California, being duly sworn, deposes and says:

1. That this affidavit is made for the purpose of a motion for a rehearing to be filed in Docket Numbers 7116 and 7117 of the Tax Court of the United States.

2. That the term "Petition" used herein refers to both of the petitions filed in the said proceedings before the Tax Court of the United States; and that the term "Petitioners' Exhibit 1" used herein refers to the said exhibit filed in the said proceeding, being a contract under which, among other things, certain patents and patent contracts were sold by Leo M. Harvey, father of affiant, to The Gerrard Company, Inc.

3. That the co-signature of the American Steel & Wire Company on a series of notes (referred to in paragraph 5-A-2 of the Petition and shown on page 21 of Petitioners' Exhibit 1) was entirely due to affiant's efforts; that without said co-signature of the American Steel & Wire Company the said notes would have had very little value; and that except for the 20% of the proceeds of the sale of said patents and patent contracts which was agreed to be paid him by Leo M. Harvey, he received no

compensation of any kind for his efforts; that the said co-signature was obtained by him as a result of voluminous investigation and research by him into phases of contract and [50] anti-trust law and as a result of numerous negotiations with the said American Wire & Steel Company.

4. That Leo M. Harvey called him in to assist him in negotiation with the officials of the United States Steel Company after failing to conclude an agreement with them for the sale of his patent contracts with The Gerrard Company, which company was owned by the said American Steel & Wire Company, a subsidiary of the United States Steel Company.

5. That his father, Leo M. Harvey, was inclined to sacrifice the said contracts for \$300,000 due to his fear that the Gerrard Company, having been acquired by a larger corporation, might abandon the entire invention and stop further payment of the contracts.

6. That the receipt by Leo M. Harvey of an additional \$125,000 in cash and notes was due entirely to affiant's efforts.

/s/ LAWRENCE A. HARVEY.

Subscribed and sworn to before me this 24th day of April, 1947.

[Seal] /s/ A. E. ISAACSON,

Notary Public in and for said
County and State. [51]

EXHIBIT "B"

AFFIDAVIT

State of California,
County of Los Angeles—ss.

Herbert Harvey, of the County of Los Angeles, State of California, deposes and says:

1. That during the years prior to 1930 he spent most of his spare time assisting his brother, Leo M. Harvey, in the invention of certain flat band wire tying machines licensed in 1930 to the Gerrard Company, Inc.

2. That in order to induce him to do this work, which work was done outside of the regular line of trade and business and outside of regular hours of work, Leo M. Harvey agreed to give him 10% of the proceeds resulting from the flat band invention, with the understanding that this said 10% was to be in addition to any compensation he might receive while working for Leo M. Harvey in the machine shop business.

3. That pursuant to the said agreement, Leo M. Harvey paid him each year (beginning in 1930 and ending in 1938) 10% of the royalties received from the said Gerrard Company, Inc., on the said flat band patents.

4. That when the said patents were sold by Leo M. Harvey to the said Gerrard Company, Inc. in 1938, discussion arose between him and Leo M. Harvey with respect to his 10% of the proceeds of sale, which would have been \$42,500; that because

of the large expenses of the sale [52] and other values included in the contract of sale, they settled the amount at \$26,500, \$1,500 to be paid in cash and the balance on the basis of 25/400ths of the payments received from Gerrard on the notes of \$40,000 each.

/s/ HERBERT HARVEY.

Subscribed and sworn to before me this 22nd day of April, 1947.

/s/ WILLIAM S. PEARSON,

Notary Public in and for the
State of California.

My Commission Expires June 30, 1950.

[Endorsed]: Received and filed April 28, 1947.

[Title of Tax Court and Cause]

ORDER

On April 28, 1947, petitioners herein filed a motion for rehearing. As a basis therefor petitioners complained in part of certain findings made by the Court in our Memorandum Findings of Fact and Opinion in the above entitled proceedings entered March 24, 1947. It appearing from such motion that a portion of our findings should be clarified, it is hereby

Ordered: That the Memorandum Findings of Fact and Opinion above mentioned be and hereby is amended by eliminating the sentence on page 4 of

such findings reading, "These royalty payments were reported by petitioner as income from the business of Harvey Machine Company," and substituting in lieu thereof the following: "These royalty payments, received prior to 1938, were reported by petitioner as income from the business of Harvey Machine Company."

It Is Further Ordered: That petitioners' motion for rehearing be and the same is hereby denied.

[Seal] /s/ SAMUEL B. HILL,
Judge.

Washington, D. C. April 29, 1947. [54]

The Tax Court of the United States
Washington

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion entered March, 1947, the respondent herein filed a recomputation of the tax on May 20, 1947.

At the hearing on respondent's recomputation held July 16, 1947, the petitioner did not appear. No objection has been filed to respondent's recomputation. It appearing that such recomputation is correct, it is therefore, in accordance therewith,

Ordered and Decided: That there are deficiencies in income taxes for the years 1939, 1940 and 1941 in the respective amounts of \$2,277.84 \$4,988.44 and \$7,118.97.

/s/ SAMUEL B. HILL,
Judge.

Entered July 17, 1947. [55]

The Tax Court of the United States
Washington

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the determination of the Court as set forth in its Memorandum Findings of Fact and Opinion entered March 24, 1947, the respondent herein filed a recomputation of the tax on May 20, 1947. At the hearing on respondent's recomputa-

tion held July 16, 1947, the petitioner did not appear. No objection has been filed to respondent's recomputation. It appearing that such recomputation is correct it is, therefore, in accordance therewith,

Ordered and Decided: That there are deficiencies in income taxes for the years 1939, 1940 and 1941 in the respective amounts of \$2,277.85, \$4,988.44 and \$7,118.97.

[Seal] /s/ SAMUEL B. HILL
Judge.

Entered July 17, 1947. [56]

[Title of Tax Court and Causes.]

PETITION FOR REVIEW

Leo M. Harvey and Lena P. Harvey, petitioners, by George T. Altman, counsel, hereby file their Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit of the decisions of the Tax Court of the United States entered on July 17, 1947, and amended July 22, 1947, determining deficiencies in the Federal income taxes of each of the petitioners as follows:

	Leo M. Harvey	Lena P. Harvey
1939	\$2,277.84	\$2,277.85
1940	4,988.44	4,988.44
1941	7,118.97	7,118.97;

and respectfully show:

I.

Jurisdiction

Petitioners are individuals residing at 1750 North Serrano Avenue, Los Angeles, California. The jurisdiction of this Court is invoked under section 1141 of the Internal Revenue Code. [57]

II.

Nature of the Controversy

1. The controversy involves a proper determination of the petitioners' liability for federal income taxes for the calendar years 1939, 1940 and 1941.

2. At all times pertinent to this controversy petitioners have been husband and wife, and residents of the State of California. They filed separate income tax returns, on a community property basis. (Hereinafter the term "petitioner," in the singular, will be used when Leo M. Harvey alone is meant.)

3. In 1929 and 1930 petitioner and the Gerrard Company, Inc. (hereinafter referred to as "Gerrard") entered into five license agreements covering certain patents taken out by petitioner, as well as patents applied for by him, on round wire tying machines and flat wire tying machines. Three of chines and two, flat wire tying machines. Under the ines and two, flat wire tying machines. Under the latter two, one of which covered the United States and the other all foreign countries, petitioner granted to Gerrard the exclusive rights to use and

sell said flat wire tying machines during the entire life of the patents, and Gerrard was required to pay petitioner for such right a minimum total royalty of \$30,000 per year. On or about October 12, 1936, the payment of said royalties was guaranteed by the American Steel and Wire Company of New Jersey, parent company of Gerrard.

4. On or about March 21, 1938 petitioner entered into a contract (hereinafter referred to as the "1938 contract") with Gerrard under which (a) he transferred to Gerrard all of the patents covered in the license agreements mentioned above, the said license agreements being cancelled and terminated; and (b) Gerrard agreed to pay petitioner as consideration a total sum of \$425,000. Of the said total consideration, \$25,000 was payable and paid upon the execution of the contract. [58]

The balance of \$400,000 was payable and paid at the same time by delivery to petitioner of ten negotiable promissory notes in his favor of \$40,000 each, all dated April 2, 1938, and maturing serially, one on April 2, 1939 and one on April 2nd of each year thereafter. The said notes were executed by Gerrard and its parent company, the American Steel and Wire Company of New Jersey, as joint makers. Said notes were tendered and accepted as payment. Those of the said notes which were due in the years involved herein were paid when due. (Hereinafter these notes will be referred to as the "Gerrard notes.")

5. Leo M. Harvey's son, Lawrence A. Harvey, an attorney, negotiated and drafted the entire con-

tract with Gerrard which provided for the consideration referred to of \$425,000. Lawrence was to get 20% of the total proceeds, as paid, as his compensation if a satisfactory deal was worked out; and petitioner paid him his percentage, or \$8,000, in each of the years involved herein.

6. Petitioner had had in his employ for many years his brother, Herbert, to whom he paid a regular salary. In addition petitioner had been paying Herbert 10% of the annual royalty payments of \$30,000 received under the flat band licenses, for Herbert's advice and assistance in connection with development of the flat band patents. Under the 1938 contract petitioner expressly agreed to include "patents, patent applications and inventions, if any, owned by Herbert Harvey and in which either or both Leo M. Harvey and said Herbert Harvey have an interest." Petitioner upon executing the 1938 contract settled with Herbert in respect to his interest for a total of \$26,500, payable \$1,500 immediately and \$2,500 each year thereafter as the payments were received by petitioner on the Gerrard notes. In each of the taxable years involved herein petitioner made said payment to Herbert of \$2,500. [59]

7. In filing their returns for the year 1938, petitioners elected to return their gain from the 1938 contract on the installment basis under Section 44 (b) of the Revenue Act of 1938, but otherwise they filed their returns for the year 1938 on the accrual basis.

8. In each of the taxable years involved herein petitioners reported (half on each one's return) the amount received in such year on the Gerrard notes, less the amounts paid Lawrence and Herbert as aforesaid, as the proceeds of sale of capital assets, under Section 117 of the Internal Revenue Code. The Commissioner, however, treated the amount received as "ordinary income" on each return and also refused any allowance for the amounts paid Lawrence and Herbert. Petitioners thereupon filed their petitions with the Tax Court. The Commissioner in his answers made a general denial, including a denial that petitioner was not holding the patents involved for sale to customers in the ordinary course of his trade or business. Petitioners thereupon (on April 2, 1945) filed a motion for judgment on the pleadings on the ground that said denial by the Commissioner necessarily, although indirectly, included a contention that petitioners should have reported the entire \$425,000 in 1938 and no part of it in the taxable years herein involved. The Tax Court denied the motion and the case eventually went to trial. After trial the Tax Court filed its opinion sustaining the Commissioner. Subsequently, on April 28, 1947, petitioners filed a motion for rehearing. The Tax Court denied the motion but in partial response to it amended its opinion. Subsequently, on July 17, 1947, the Tax Court entered its decisions, and on July 22, 1947, entered certain amendments thereto. In that state the proceeding comes before this Court. [60]

III.

Assignments of Error

Petitioners assign as error the following acts or omissions of the Tax Court:

1. Denial of motion for judgment on the pleadings.

2. Failure to hold that the amount received each year on the Gerrard notes was an amount received on the sale of "capital assets" as that term is defined in Section 117 (a) (1) of the Internal Revenue Code.

3. Failure to make any determination of the holding period of the property sold under Section 117(h) of the Internal Revenue Code.

4. Failure to determine that the holding period of the property sold was more than two years.

5. Failure to allow either as offsets or deductions the amounts paid Lawrence A. Harvey and Herbert Harvey, or any portion thereof.

6. Finding of deficiencies for the years involved instead of overpayments as requested.

/s/ GEORGE T. ALTMAN,
Counsel for Petitioners.

State of California

County of Los Angeles—ss.

George T. Altman, being first duly sworn, says that he is counsel of record in the above-named causes; that as such counsel he is authorized to verify the foregoing petition for review; that he has read the said petition and is familiar with the statements contained therein; and that the statements

made are true to the best of his knowledge, information and belief.

/s/ GEORGE T. ALTMAN.

Subscribed and sworn to before me this 14th day of October, 1947.

[Seal] /s/ VICTOR BEHRSTOCK,
Notary Public in and for said
County and State.

[Endorsed]: Received and filed Oct. 17, 1947.

The Tax Court of the United States

Docket No. 7116

LEO M. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Docket No. 7117

LENA P. HARVEY,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Los Angeles, California.

November 8, 1946—10:10 a.m.

(Met pursuant to notice.)

Before: Honorable Samuel B. Hill,
Judge.

Appearances :

George T. Altman, 215 West Seventh Street, Los Angeles, California, appearing for Petitioners.

E. A. Tonjes: (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [65]

PROCEEDINGS

The Court: Announce your appearance first, please.

Mr. Altman: George T. Altman for the Petitioners.

Mr. Tonjes: E. A. Tonjes for the Respondent.

* * * * *

The Court: Mr. Tonjes, do you desire to make a statement?

OPENING STATEMENT ON BEHALF OF RESPONDENTS

By Mr. Tonjes

Mr. Tonjes: Very briefly, your Honor. I think Mr. Altman has probably anticipated what my position is. I just want to state that the notice of deficiency issued by [71] the Respondent contends that the \$40,000.00 received by the taxpayer in each one of the years here in controversy was income and taxable, and he stated that no other persons had any interest in the sums received, and that therefore there is no deduction or elimination to be made of that \$40,000.00 sum, and further that the assets sold were not the sale of a capital asset.

Of course, it was an asset held by the Petitioners primarily for sale in the ordinary course of the trade or business, and I might say the property sold was property used in the trade or business and of a character which is subject to allowance for depreciation, and therefore was excludable from capital gain.

The Court: Call your witness.

Whereupon,

LEO M. HARVEY

called as a witness for and on behalf of the Petitioners, having been first duly sworn, was examined and testified as follows:

The Clerk: State your name and address, please.

The Witness: My name is Leo M. Harvey, 1750 North Serrano Street, Los Angeles.

Direct Examination

By Mr. Altman:

Q. Mr. Harvey, you are, are you not, the Petitioner, or rather one of the Petitioners in these proceedings? A. Yes, sir. [72]

* * * * * *

By Mr. Altman:

* * * * * *

Q. Will you state exactly what this document is, Mr. Harvey? I should like at this time to introduce that as Petitioners' Exhibit 1.

(The document above-referred to was marked Petitioners' Exhibit No. 1 for identification.)

(Testimony of Leo M. Harvey.)

A. This is a document that describes the sale of the patents to the Gerrard Company on the 21st day of March, 1938, in addition to other matters involved in this transaction. [73]

* * * * *

Q. (By Mr. Altman): Mr. Harvey, will you state to the Court just how that transaction arose?

A. Well, sometime in 1938, while I was in Chicago, I met an attorney by the name of Walter Sheldon. He is attorney for the steel company, that is the U. S. Steel Company, and American Wire and Steel Company. I talked to him and we discussed the matter of branching out into larger business, and I told him I haven't got any money, so he says to me, "Why don't you sell your patents to Gerrard Company which you have?" The Gerrard Company at that time paid us a royalty under those patents. I says we might work out a deal, if we can do it then we will have some capital assets and we can enlarge our business. He says, "I tell you what to do, you have a son an attorney, get him out here and we will go down to Cleveland to see the American Steel and Wire Company, then we will go to Pittsburgh to see if we can make a deal." So I phoned Lawrence Harvey, my son, and he came out to Chicago and then we went to Cleveland and then to Pittsburgh and went back to [74] Cleveland four or five times and discussed the matter, and finally the outcome of that was this transaction that we just concluded, this document which just has been presented to the Court.

(Testimony of Leo M. Harvey.)

Q. Yes. Pardon me. May I have it? I want to refer to it. What different classes of patents were involved in this transaction?

A. There were two classes of patents involved in the transaction. One was the flat band patents and one was the round wire patents.

Q. Did the flat band patents have any relation in any respect to the round wire patents?

A. None, because they are an entirely different art.

Q. Will you explain to the Court just what difference there is between them, between the round wire and flat wire patents?

A. Well, a flat wire—I mean a round wire is a piece of round wire that you put on a box, and it is fixed on an angle to hold it together so it would not come apart. The flat band is a binder which is put around the box and it has to be crimped in an entirely different manner, it is not twisted like a round wire, or either put a seal on it to hold it together. That is the difference between the two.

Q. There is no connection between the two insofar as method of application? [75] A. No.

Mr. Tonjes: Mr. Altman, please don't lead him so much.

Q. (By Mr. Altman): With respect to the round wire patents, Mr. Harvey, were you the owner of those patents referred to in this transaction?

A. No, certain patents we owned and certain patents they owned. Originally they owned——

The Court: Who were they?

(Testimony of Leo M. Harvey.)

The Witness: That is the Gerrard Company. Originally we started to make the round wire machine for the Gerrard Company. They owned the patents and we had an agreement to manufacture for them, and while they were making these things, after that occasionally when there was a patent involved we put them in the group of patents that was belonging to the round wire patents.

Q. (By Mr. Altman): What is your opinion of the value of these round wire patents, or rather a right for the use of those round wire patents, at the time of this transaction?

A. Well, we determined the value, we discussed the matter with an attorney by the name of Beye of the U. S. Steel Company, but U. S. Steel has the sole ownership of the American Wire and Steel Company which in turn owned the [76] Gerrard Company, and we placed the value on the patents for flat band of \$400,000.00, and that was based on the amount of minimum royalty we received from Gerrard Company, which was \$15,000.00 a year for the domestic flat band patents and \$15,000.00 a year for the foreign flat band patents.

Mr. Tonjes: Was the question related to the flat band or the round wire patent?

Mr. Altman: My original question related to round wire.

The Witness: I am explaining——

Mr. Altman: Maybe the witness is trying to arrive at that in some manner.

Mr. Tonjes: All right.

(Testimony of Leo M. Harvey.)

The Witness: Then a certain sum of money in addition to the \$400,000.00 was paid to us——

Mr. Tonjes: I object to the witness testifying in this manner, your Honor. The question was what, in his opinion, was the value. I think his answer should be limited to that.

The Court: Yes, you were asked what, in your opinion, was the value of these round wire patents. You may give your opinion and any explanation you want as to how you arrived at your opinion.

Q. (By Mr. Altman): Restricting yourself to the round wire. [77] A. Round wire?

Q. Yes.

A. Well, I don't remember the exact amount, but the amount of the round wire patents is stated in the contract.

Q. I didn't know that they were.

A. Yes, they are.

Q. Let me ask you this: Was any part of the consideration of the \$425,000.00 recited in this contract intended to cover the round wire patents or had reference to the round wire patents?

Mr. Tonjes: I object to that, your Honor, unless there is some ambiguity in the contract which calls for this witness to explain it, if there is anything in here which indicates that there is segregation or lack of segregation or something of that sort. Up to the present time there is no reason for that question.

Mr. Altman: Your Honor, I am sure counsel has a copy of this contract, and in the paragraph

(Testimony of Leo M. Harvey.)

which refers to the \$425,000.00 there is no statement as to what it covers, what it is intended to cover, despite the fact that in other paragraphs other amounts are named for other properties.

The Court: You may answer.

The Witness: As far as I recollect, the total amount of money paid, that is in the lump sum of \$400,000.00 or \$425,000.00, there was no round wire included, and it was [78] paid for the flat band.

Q. (By Mr. Altman): What factors give the flat band patents that value of \$425,000.00?

A. On the amount of royalty I was to receive from Gerrard Company yearly, that is the minimum royalty.

Q. Have you ever received any amount of royalty from the Gerrard Company over and above the minimum royalty which you have referred to?

Mr. Tonjes: I object to that as not being the best evidence, your Honor. I think it should first be established as to what patents he had, and to whom he had assigned any rights under them, and then the testimony as to what he received for each. I don't think that the questions are fairly propounded.

Q. (By Mr. Altman): Mr. Harvey, I will refer you to the schedules of patents in this Exhibit A—I mean Exhibit 1. This purports to be a list of the patents, under Group A, entitled Patents and Applications for Patent Related to Round Wire. There is another list in another group B, Patents and

(Testimony of Leo M. Harvey.)

Applications for Patents Related to Flat Wire or Band.

Are these the two groups respectively, Mr. Harvey, which were transferred to the Gerrard Company? A. Yes, sir. [79]

Q. Referring again to this Schedule or Group B, Patents and Applications for Patents Related to Flat Wire or Band—if your Honor please, there are two full pages of patent numbers—were these the flat band patents which you referred to in your prior testimony? A. Yes, sir.

Q. Were these the flat band patents on which you received royalty?

A. That is right, yes, sir.

Q. Now, I should like to repeat my former question with respect to those royalties. Did you ever receive any amounts on these patents other than the minimum royalties? A. No, sir.

Mr. Tonjes: May I ask the witness a question at this time?

The Court: Yes.

Mr. Tonjes: Do you have a written contract with any company leasing or giving them a right to operate under your round wire patents?

The Witness: No, sir.

Mr. Tonjes: Do you have any contracts of any kind with any other person?

The Witness: No other person.

Mr. Tonjes: All right, proceed. [80]

Q. (By Mr. Altman): Will you state somewhat more fully, Mr. Harvey, just what services were

(Testimony of Leo M. Harvey.)

rendered by your son Lawrence A. Harvey in connection with this transaction in 1938?

A. Well, he organized the whole deal. He is an attorney. He knew how to handle the matter, and I relied on him to have the discussion with the attorneys from the U. S. Steel Company, because they came into the picture because they owned the American Wire and Steel and the American Wire and Steel owned the Gerrard Company, and he also investigated with reference to selling these patents, with respect to the income tax situation. I had him make the arrangements, and he made all the arrangements.

Mr. Tonjes: I move to strike the witness's answer out, your Honor, as being entirely irrelevant and immaterial and not responsive to the question. We have no question here as to the reasonableness of any compensation paid to Lawrence Harvey. We want to know whether he had any interest in the patents.

The Court: Well, the answer is responsive, but I don't know whether it is material or not.

Mr. Altman: Your Honor, that point is in issue under the pleadings, and respondent has never denied that the—while Respondent denied the allegations of the petition in that respect, this is their first attempt to say [81] that the point is immaterial. At the outset, if you will recall, your Honor, we stated that the question would be with respect to these payments, whether they were excluded or that is, treated as offsets in that respect——

(Testimony of Leo M. Harvey.)

The Court: That is a royalty, and not compensation for Lawrence.

Mr. Altman: Lawrence Harvey.

The Court: Any compensation which you claim should be either excluded or deducted from the total amount received?

Mr. Altman: That is right, your Honor. Now, if they are a deduction and not exclusions, then the question is I would like to know as to what those services were and what was their value. If they are mere exclusions, then as I understand the point made by the Respondent here, the question would be as to what rights Lawrence Harvey had in those patents.

Mr. Tonjes: I think that might help your Honor, and I think that is true.

The Court: All right, go ahead.

Q. (By Mr. Altman): Mr. Harvey, when you called your son Lawrence out to the east in connection with this transaction, did you advise him before he started that you would compensate him for his services? A. Yes, I did. [82]

Q. Did you make any agreement with him, any definite agreement with him as to what compensation he would get?

A. Yes, we did. If the transaction was made it was understood that he will get 20 per cent of the \$400,000.00 that I am to receive at the rate of \$40,000.00 a year, and he gets 20 per cent of that each year, and he gets his money.

Q. That was your understanding?

(Testimony of Leo M. Harvey.)

A. That is right.

The Court: 20 per cent of the amount you were to receive for the patents?

The Witness: For the \$400,000.00.

The Court: You say \$400,000.00. It is not that exactly, is it?

Mr. Altman: It is \$425,000.00, your Honor.

The Court: All right.

Q. (By Mr. Altman): Would you say that Lawrence Harvey's accomplishments in connection with this transaction were worth that amount of compensation?

A. Yes, they were, because it was very major possibility unless I got some ready cash, be able to sell something so that we can go ahead in a larger business, which we did not have at that time.

Q. And he handled the transaction safely?

A. Yes, sir. [83]

Mr. Altman: In regard to this contract with Lawrence Harvey, your Honor, I had planned to bring up here the written contract between Leo M. Harvey and Lawrence Harvey, which was executed shortly after the transaction, but apparently it has not yet arrived. Some one was sent for it. I should like to complete that.

Q. (By Mr. Altman): Did you execute a written contract? A. Yes, sir, I did.

Q. With Lawrence Harvey?

A. That is right. [84]

* * * * *

(Testimony of Leo M. Harvey.)

Q. (By Mr. Altman): Mr. Harvey, referring again to this Exhibit 1, there are several references in here to Herbert Harvey. Who is Herbert Harvey? A. Herbert Harvey is my brother.

Q. Will you state what services were rendered by Herbert Harvey in this connection, in connection with these various patents?

A. Originally with me he helped and advised with [85] reference to the original, I would say working out of the flat band patents.

Q. Did you pay him any part of the royalties as you received them? A. Yes, I did.

Q. What portion?

A. I believe it was 10 per cent, 8 or 10, I don't remember exactly, but I paid him each month I received my royalty, he got his.

Q. Mr. Harvey, did he have any interest or rights in these patents of record?

A. I believe he had some patent which is marked Herbert Harvey patent in that agreement that you just showed to me.

Q. Referring to the amount of \$2500.00 per year which you paid Herbert Harvey out of the \$40,000.00 per year received from Gerrard, what was that compensation for?

A. That was given to him in lieu of the former royalty he was getting from the flat band patents, and when we made a settlement for the flat band patents under this agreement I arranged that he will get his prorata share each time we received the

(Testimony of Leo M. Harvey.)

\$40,000.00, he got a statement of \$2500.00 each time, and he received this, that is his share.

The Court: This \$400,000.00, was that composed of separate payments?

The Witness: That is right. [86]

Mr. Altman: That was the gross amount, if your Honor please, received by him, the contract totalling \$425,000.00 and it was paid in this way, \$25,000.00 was paid in cash on the execution of this contract in March of 1938. In additional to the cash of \$25,000.00 there was given to Mr. Harvey 10 \$40,000.00 notes.

The Court: That was in payment of the purchase price?

Mr. Altman: Well, it was in payment of this total of \$400,000.00 which we stipulated at the beginning of this session was received.

The Court: Talking about the \$40,000.00 royalty then, in other words, as to whether it is royalty or a payment on the purchase price.

The Witness: Well, this was part of the purchase price and it is actual payment on this price the same as the amount of \$25,000.00 which I received.

Q. (By Mr. Altman): Mr. Harvey, could you have made this contract of sale to the Gerrard at all, could you have completed this transaction at all without making a separate settlement with Herbert Harvey?

Mr. Tonjes: I object to the question. It calls

(Testimony of Leo M. Harvey.)

for a conclusion, and there has been no foundation laid for the question. [87]

The Court: I suppose it would involve the question whether Mr. Harvey owned an interest in the patents and had a voice in whether or not they should be sold.

Q. (By Mr. Altman): Mr. Harvey, did Herbert Harvey have any right or interest in these patents?

Mr. Tonjes: I object to that, your Honor, as also calling for a conclusion. If there was any right he can tell what it was.

The Court: It might call for a legal conclusion as to the title. First, will you state more fully the facts here leading up to the proposition, whether or not Herbert Harvey did have any right or interest in connection with the title to these patents.

Mr. Altman: Your Honor, if counsel will refer to this Exhibit 1, he will see that under the contract Leo Harvey was required to make any settlement with Herbert Harvey as a part and parcel of this contract.

Mr. Tonjes: If your Honor please, I am well aware of that provision there, and it is to the effect that Herbert Harvey does make some disposition of his interest in the patents, if any. I am not prepared to admit that he had any interest in them, your Honor.

The Court: Well, he has testified now that Herbert did some work in connection with the develop-

(Testimony of Leo M. Harvey.)

ing of some of [88] these patents, as I understand. Is that correct?

The Witness: Yes, sir.

Mr. Tonjes: I don't think that is sufficient to give him any interest in the patents. I don't know the particular interest. Just because he did a little work on them—was he employed by you regularly, Herbert Harvey?

The Witness: Yes, sir.

Mr. Tonjes: I could not possibly admit that, your Honor.

The Court: Well——

Q. (By Mr. Altman): I will ask again, Mr. Harvey, was there any agreement between you and Herbert Harvey prior to the date of this transaction, any oral agreement prior to the date of this transaction, in which you recognized that he had by virtue of his work and his research an interest in these patents?

A. Well, it was a question of probably advice that he gave from time to time, and when that agreement was made that I should receive a royalty, I agreed with him that I would give him 10 per cent of the royalty I received, and I paid him each month as we received the royalty.

The Court: Let's see, is that royalty or payment on the purchase price?

Mr. Altman: That is right, your Honor.

The Witness: Well, when we sold the patents to the [89] Gerrard Company we were to receive four hundred odd thousand dollars. We then gave Her-

(Testimony of Leo M. Harvey.)

bert part of his interest in that, we will pay him \$25,000.00 each year as we receive——

The Court: \$2500.00.

The Witness: \$2500.00, and each year as I received the \$40,000.00 yearly, and it was to continue for the next 10 years, and I paid him all of that money.

Q. (By Mr. Altman): Mr. Harvey, other than this transaction referred to in Exhibit 1 here, have you ever sold any patents?

A. No, not to my knowledge.

Q. Have you ever offered any for sale?

A. No, not to my knowledge.

Q. Did you ever hold any patents for the purpose of selling them?

A. We don't have a business of developing patents. Patents are developed occasionally when you come across—our business is the machine shop business, and occasionally we will come across some patent, developed and the application is filed for it, but we do not do it as a regular business practice.

Q. You never offered any for sale?

A. Not to my knowledge, no.

Q. What is the nature of that machine shop business you speak of? [90]

A. We make tools, dies, models, machine work for novelties for different customers.

Q. If any inventor brought in some diagram, would you co-operate with him and try to build a machine from his diagram? A. Yes, sir.

(Testimony of Leo M. Harvey.)

Q. Do you also manufacture any items for sale?

A. What period do you refer to?

Q. I am referring to the period up to and including March 1938, let us take, for example, the last 10 years prior to that date.

A. No, I don't remember selling or offering an article for sale, that is directly by our firm. It is mostly a jobbing shop, and we do job shop work for other people.

Q. Referring now to these flat band patents, did you ever manufacture any machines under those patents?

A. Yes, we did, we made the first few machines for the Gerrard Company, but we never made any more.

Q. You mean you made sort of models, the first finished models, did you? A. Yes.

Q. When was that?

A. I don't know exactly offhand. We just made the first and never made any more.

Q. About when was that? [91]

A. Sometime in 1930 or 1931.

Q. After the time when you turned those models over to Gerrard, did you do any further work in connection with these flat band patents?

A. As far as my recollection is concerned, when we agreed with Gerrard with reference to the flat band we agreed to finish a certain amount of work that we had started, and the agreement was made on certain small things that have been made, I don't know how many, but not very many after that.

(Testimony of Leo M. Harvey.)

Q. Are you referring to completion of patents?

A. That is right.

Q. That is applications that were then pending?

A. Yes, sir.

Q. Referring to the last two years or the last two and a half years prior to the date of this transaction, did you do any work of any kind in connection with these flat band patents?

A. Not to my knowledge.

Mr. Tonjes: Would you kindly read that last question to me, Mr. Reporter?

(The record was read.)

Q. (By Mr. Altman): I will ask you again if those flat band patents have any relation to the business in which you are engaged including the round wire patents? [92]

A. I don't understand the question.

Q. Were these flat band patents in any way pertinent to or necessary to or were they in some way involved in the business which you were carrying on in the last two or three years or so prior to that transaction?

A. We never used the patent because we never made the machines.

Q. Referring to the wire machine or wire tying trade, are round wire and flat wire or slot band wholly different fields of production?

A. Yes, they are.

Q. In connection with the completion of various patents which you referred to back in the early years, who paid the expenses, you or Gerrard?

(Testimony of Leo M. Harvey.)

A. They were paid by Gerrard Company, and as far as I recollect we have two contracts, one for foreign and one for domestic. For the foreign patents Gerrard Company paid all the patent expenses.

Mr. Tonjes: That is both round and flat wire?

The Witness: No, we are talking about flat wire only.

Mr. Tonjes: Flat wire?

The Witness: We call it flat band.

Q. (By Mr. Altman): Would you say that with respect to the flat band [93] Gerrard paid all the expenses?

A. That is right.

* * * * *

Q. (By Mr. Altman): Mr. Harvey, were you ever in the installment business? That is, did you ever regularly sell any property on the installment plan?

A. No, sir.

* * * * *

Cross-Examination

By Mr. Tonjes:

Q. Mr. Harvey, when did you first start in business?

A. About 1913 or '14, if I recollect.

Q. What business were you in then?

A. In the machine shop business.

Q. In Los Angeles here?

A. That is right.

Q. And were you engaged in making any particular article or making articles on special order, such as you have indicated?

(Testimony of Leo M. Harvey.)

A. Making articles on special orders.

Q. Let me ask you this first: Did you have any special training, technical training or take college degrees or something of that sort in mechanical engineering

A. No college degrees, no, I have not.

Q. Did you have any special training in mechanics? A. Yes, I did.

Q. Will you state what that was? [95]

A. I went to Cooper Union in New York. I studied at night correspondence courses. That is about all the training I had.

Q. How long did you go to Cooper Union?

A. I don't recollect. Not very long. I left New York in 1910.

Q. Maybe three or four years, did you go?

A. Oh, no, not that long, maybe two night courses, something like that.

Q. Did you go to high school?

A. No, I went to preparatory school in the evening because I worked in the day time all the time.

Q. And you never went to college?

A. No, sir.

Q. How long did you take those correspondence courses?

A. I don't remember. I don't recollect.

Q. Just approximately a year or two, would you say? A. Yes, something like that.

Q. And they were all along mechanical lines, were they? A. Yes, sir. [96]

Q. And when did you first begin devoting your

(Testimony of Leo M. Harvey.)

time to development of ideas, what might be patentable?

A. Well, you don't devote your time, they come, sometimes they may come often, sometimes they may not come for years, come along an idea and you don't specialize in—or you could not specialize I would say, as far as I am concerned, I could not specialize in working on ideas only.

Q. No, but probably you can go back—you get an idea, then it takes a little time for you to develop the idea doesn't it? A. Yes it does. [97]

* * * * *

Q. Well, when did you first get the idea of the wire tying devices? [98]

A. Well, there are two phases of wire tying devices.

Q. No, I mean the first wire tying device of any character.

A. Of any character, that would be the first patent that we filed. I would imagine sometime in 1925, could be 1924, just somewhere about that, in the middle twenties.

Q. That was the first time that you ever gave much serious thought to developing a wire tying device?

A. Well, I say that because I believe there is a patent somewheres in the middle of the twenties.

Q. Would it help you any to make a reference to the contract? Primarily, I want your own recol-

(Testimony of Leo M. Harvey.)

lections, although if you can get anything out of there that will help you, you may refer to it. [99]

* * * * *

Q. (By Mr. Tonjes): How long did you have to work on that before it ripened into a patent?

A. Well, that is —I can not answer exactly, because I don't know the exact time, see?

Q. Would you say maybe two years, three years?

A. Sometimes you get an idea and it may ripen in a week and sometimes it may ripen in ten years.

Q. Let me ask you this question directly: Can you tell me now after looking at that contract the first time you had an idea of developing a wire tying device?

A. As far as I can see and hear, that was before 1927, somewheres close to that.

Q. Before 1927? A. Yes.

Q. From your own personal recollections, can you tell me about how much it was before 1927? Would you say five years or three years?

A. Well I am trying to give you the correct answer on this. It is impossible.

Q. I appreciate that Mr. Harvey. It is going back a long ways, and it is rather difficult.

A. Maybe a year, maybe two, I don't remember exactly. [100]

Q. Now, would you say that that was the first idea you devoted any time to with the idea of developing it? A. A wire tying machine?

Q. Yes.

A. No, no, because in 1921 we manufactured

(Testimony of Leo M. Harvey.)

wire tying machines for a concern that already had the patents, and of course we made machines for them, and I don't know whether you would consider that making ideas or not.

Q. Yes. I mean some other idea besides wire tying devices. Did you work on anything or attempt to develop anything prior to 1927? You already have told me about the salt cellar. Was there some other besides that?

A. Not that I remember.

Q. When you first started developing these ideas, did you make some models, some smaller models or something of that sort to experiment with?

A. Yes, we do.

Q. And you also make many drawings, I suppose.

A. Yes, we make drawings.

Q. And you have in mind the ultimate idea of developing a patentable method, that is the general idea, isn't it?

A. Well, you don't work at it that way. You don't know whether you can get a patent or not. You just get the idea, you see.

Q. What do you hope to do with the idea? [101]

A. Well, the object, we were in the machine shop business, we always wanted to make articles for ourselves and sell them ourselves.

Q. And you wanted to sell the article yourself if it could be produced under some patent which you developed. Did you answer that last question?

A. What did you ask me?

(Testimony of Leo M. Harvey.)

Mr. Tonjes: Will you read the question Mr. Reporter?

(The question was read.)

The Witness: Well, it was not the idea that it has to be patentable. It has to be something good.

Q. (By Mr. Tonjes): Oh yes.

A. Because the patent is incidental, you see. Of course we always consider ourselves, we figure the patent is a license to fight, and it is the article that is the most important thing.

Q. Why would you want to have that license?

A. Well, sometimes we think it may help us prevent others making the same thing.

Q. And that could be taken out for three reasons, it would give you the right to manufacture something exclusively, and you could either manufacture under your right or you could sell the right or you could lease out the right, and [102] was it for the purpose of engaging in any one or all of these activities that you devoted your time and effort to inventing things?

A. Well, inventions don't come that way, you have got to understand you don't work on a thing because you are going to do it, it comes to you because you think of it and you make it.

Q. Alright, why do you make it?

A. Well, at the beginning you make it because you like the particular article, you like to do that work. I like to make up gadgets more than I like to eat, otherwise you don't do these things, and un-

(Testimony of Leo M. Harvey.)

less the engineer likes his trade he don't develop nothing.

Q. Why do you go to the trouble of having it patented?

A. As I explained to you, because I hope that will help us in making the article, nobody else will encroach on you.

Q. In other words, it will give you an exclusive right. A. Yes.

Q. Why do you want that exclusive right?

A. Probably to help us, as I told you, help us in our business, maybe.

Q. How would it help you? You mean you wish to sell it? A. No, you can sell the article.

Q. Sell the patent itself?

A. No, the article, sell the article, not the patent.

Q. I ask you if you would get the patent because you would have the right to sell the patent itself, is that one of the things?

A. Well, anytime you—anything you have you might want to sell, but that was not the primary reason. The primary reason was to develop the idea that comes to you first of all because you like to do things. Second, it doesn't come to you because you set out to think about it, it comes to you incidentally mostly, and then you think it over and you take it and you think around and try to make it go, and I consider if you have a patent you have probably a better chance if you want to make the article that nobody will encroach on you.

(Testimony of Leo M. Harvey.)

Q. And you consider it to be a valuable right, do you not?

A. Yes, I do. Then first let me qualify that. As I already said before I do because we ourselves consider the license, the patent only a license to fight, because we understand primarily when you get the patent allowed by the Patent Office, it is only saying they look over all the art and they found no conflict, but it don't give you any rights except the right you get after you go to court.

Q. Yes, but you also I suppose appreciated at that time, that a good patent would produce considerable royalty if you cared to leave it out?

A. Yes, sure, we though that too.

Q. And that of course no doubt prompted you in your efforts to develop something patentable, did it not?

A. I would say it might have, but it was not the primary reason for doing the thing. Well I suppose you invented something in your life, and you know how those things go, you do it because you like to do it. There is a lot of things that never got to be patented, because I like to do it.

Q. But you would be much more satisfied if you came out with something good, wouldn't you?

A. Yes, we have to live, otherwise we can't exist.

Q. Now, during the time that you were engaged in developing ideas—well, let me ask you this first, Mr. Harvey: How many patents did you take out in the various years, how many patents were

(Testimony of Leo M. Harvey.)

granted you in the various years? Have you any idea? A. No, I can't tell you.

Q. Do you have any idea how many you have altogether?

A. I can't do that, because we have a number of patents in the list of patents that are foreign country patents which is a copy of the American patent, they are really not a new patent, they are a copy of the American patent. [105]

Q. Leaving out the foreign patents, how many American patents were granted to you on various articles, not only the wiring devices, but on patents generally, how many patents were granted to you?

A. Oh I would say, that is the article itself—you see, the Patent, sometimes the Patent Office asks you to divide your application in part by arts. In other words, you file an application, the Patent Office says, it involves more than one art and it says you divide it up into four or five different patents, and in spite of filing the one patent maybe you will have five patents issued by the United States Government, see?

Q. Yes.

A. And they really pertain to the same thing, so the number of patents involved is not of great importance, so far as our line of work. It is the article that you make.

Q. Well, let me ask you this; how many articles do you have patents on?

A. Well, let's see, three or four maybe five.

(Testimony of Leo M. Harvey.)

Q. Can you tell me what they were? We have flat and round wire tying devices. We have those.

A. You got two. I developed then a patent on a paper dispenser.

Q. What kind of a paper dispenser?

A. Paper towels. I don't recollect any more now. [106]

Q. On washing machines?

A. Washing machines, yes, part of a washing machine. It is not exactly all of a washing machine.

Q. Do you know when you devoted some time to developing a washing machine?

A. Well, yes, the washing machine we started I think in 1939 or 1938, if I recollect correctly.

Q. You mean that is when you got the first patent or that is the time you first started in toying with the idea of developing some part of a washing machine?

A. That was the first time. I don't remember exactly whether it was 1939 or 1938.

Q. Did you develop any spraying devices?

A. Spraying devices? I couldn't recollect. I can't remember. It could be a patent I applied for, or articles involved.

Q. Any agricultural machinery of any kind?

A. Yes we had a patent on a—I think a clipper for cutting oranges.

Q. Cutting what, oranges?

A. Cutting oranges, yes.

Q. And that is about five different devices, five different kinds?

A. Maybe there were more.

(Testimony of Leo M. Harvey.)

Q. They resulted in patents being granted, is that [107] correct? A. Yes.

Q. Would you say that all of the devices to which you gave some thought resulted in a patent being granted? A. No, no.

Q. Can you tell me approximately how many subjects you devoted some thought to with the idea of getting a patent?

A. No, I couldn't, that is too far to remember.

Q. You would say there would be quite a few though, wouldn't there?

A. There would be some, yes.

Q. Now, in connection with the development of a patent, you would oftentimes incur some expenses? A. You do.

Q. Do you know how you treated those expenses on your books and for your income tax purposes?

A. Well, no, I don't. I have a recollection of it, but I do not make out the income tax blanks. That is made out by somebody who knows the business, and I ask him if that is correct and he says yes and I sign it. I look at it and he says it is all right.

Mr. Tonjes: Mr. Altman—this is off the record, if your Honor please.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Tonjes: The parties stipulate that the expenses [108] incurred by the Petitioner in connec-

(Testimony of Leo M. Harvey.)

tion with his development of the several patents were deducted on his income tax return.

Mr. Altman: Yes, I will agree to that.

Q. (By Mr. Tonjes): Do you recall, Mr. Harvey whether or not in your books of account you kept or made any segregation with regard to the expense incurred by you in the development of these several patents?

A. I think they were. I don't know for sure, but I think they were.

Q. That is to say, if an expense of \$500.00 we will say, was incurred in connection with the round wire patents, that was charged to round wire patent expense, and if a similar expense was incurred for a flat wire or flat band development expense, it would be charged to development of that flat band?

A. I don't know exactly. I can't answer that, because on the books it would not so show, because every job had a number and it says number so and so was charged with so much money.

Q. When did you first give some third person or corporation a right to operate under a patent held by you?

A. The first time I gave a right, your question is the first time we gave a right under the patent that I owned to another individual to operate under the patent? Is that what [109] you asked?

Q. That is correct.

A. To the best of my recollection it is the Ger-

(Testimony of Leo M. Harvey.)

rard Company was the first time we had a license agreement on a patent.

Q. The Gerrard Company. Do you recall what patents were covered by that agreement?

A. That was to cover the flat band patent.

Q. And what year was that?

A. 1930.

Q. In 1930 you gave the Gerrard Company the right to operate under the flat band patent?

A. That is right.

Q. Did it provide for a royalty?

A. Yes, it did.

Q. Do you know how much?

A. Yes, a minimum royalty of \$15,000 a year.

Q. \$15,000 a year, and that was paid to you every year beginning in 1930 right on through all of the later years until the date of the sale?

A. Yes.

Q. Did you have any other patent on which you received a similar royalty?

A. Yes, royalty on the flat band patent, on which we received similar royalty. That was based on 5% of the sale [110] of bands that they used in the machine, providing for a minimum charge of not less than \$15,000 a year, yes, I think \$15,000 a year in the domestic patent and \$15,000 a year on the foreign patent.

Q. And you received that \$30,000 a year each year after 1930. A. I think so, yes sir.

Q. And you reported that as income from your business? A. I think as far as I recollect.

(Testimony of Leo M. Harvey.)

Q. Did you give any of it to Herbert Harvey?

A. Yes I did.

Q. Beginning when, in 1930?

A. Beginning the first time I got the royalty he received his, some of the money.

Q. How much did he get?

A. As far as I know it was \$150.00 under each group of patents. That is my recollection.

Q. What was that, \$150.00 a month or a year?

A. A month.

Q. Did Lawrence Harvey get any money?

A. No.

Q. Why did you give the money to Herbert Harvey?

A. Because I considered his advice very valuable. It is not what you do in the daytime in the business, it is what you do in the evening and Sunday and holidays in discussing [111] these matters and advising, I considered was valuable to me.

Q. Was there any agreement that he would get a certain percentage of these inventions?

A. No, there wasn't any written agreement.

Q. Was he on your payroll in other respects?

A. Yes he was.

Q. When did he first enter your employ?

A. Way back in 19— oh, I don't remember, 1918, something like that. I don't remember exactly.

Q. And he was in your employ continuously over a period of years of the development of these ideas?

A. Yes, sir.

(Testimony of Leo M. Harvey.)

Q. Do you recall what salary you paid him?

A. Well, at different times different salary. I think he was getting \$500.00 a month and at a certain time he was getting I think as high as \$1,500.00 a month.

Q. You say the flat wire patent devices were the first patents on which you received any royalties?

A. Yes.

Q. And that was in 1930 and ran through 1938 when the patents were sold? A. Right.

Q. Were the rights under the round wire patents ever given to anybody? A. Yes. [112]

Q. To whom were they given?

A. Certain rights were given not on the royalty basis though. Gerrard had also—you see, they had made the round wire machine also for the Gerrard Company, and they didn't receive a royalty on them.

Q. Did you arrange the right to operate on the round wire patents for the Gerrard Company?

A. Certain patents we did, yes.

Q. Not all of them?

A. Not all of them.

Q. When was that arrangement made?

A. It was before 1929.

Q. Before 1929? A. That is right.

Q. And let me ask you this question: When did you get your first right under the round wire patents? When did you get your first round wire patent, do you recall? A. No, I don't.

(Testimony of Leo M. Harvey.)

Q. Could you refer to that agreement? Would that help you?

A. Yes, after the sale has been made. Well, the first patent in here is a foreign patent we had in France in 1927 on the round wire machine, but that patent is an outgrowth of the United States patent, which was issued at a later date, and as far as I recollect any patent that was sold, I would say giving them rights, was sometime in 1929.

Q. And did you continue to work on the round wire device after you entered into this agreement with the Gerrard Company?

A. Well, as I explained before, the idea is incidental to your working on the thing, and I can not say exactly when I did work on that or when I didn't work on that.

Q. Well, Group A shows all of the patents and applications for patents? A. Yes.

Q. On November 14, 1933, according to this Exhibit, there was a patent application filed and another on September 4, 1935. Wouldn't that indicate that you were working on these patents or on that maybe as late as 1935?

A. Yes, it would.

Mr. Altman: Your Honor, just to clarify this for the record, sometime earlier in this cross-examination Mr. Harvey referred to the work he did in the early years in 1927 and earlier, and in that connection he referred to a patent issued in December 1927. I just want to point out for the record that

(Testimony of Leo M. Harvey.)

that is the same patent to which he is now referring, which is in Group A of Exhibit No. 1.

Q. (By Mr. Tonjes): Is that the same patent, Mr. Harvey?

A. That is right. It is in here 1927. [114]

Mr. Altman: And I think it is a round wire patent.

The Witness: A round wire patent. You see this is an issue in a foreign country. The date of the American patent for it would be much later time in the United States. I don't know just exactly which one this is.

Q. (By Mr. Tonjes): Did you assign that to the Gerrard Company, the right to operate under that to the Gerrard Company? A. Yes.

Q. What consideration did you receive for that?

A. I forget. There was some Gerrard money used, and he said he would like to have it, and we had done business with him and I says O.K. we will give it to you, because we had done some machine work for him, which was our business. In other words, they made the machines and they wanted the patent. I says, O. K. you can have it. I don't remember exactly what the payment was. If it was made it was very nominal, because it was a question of our building; about the cost of the application.

Q. You sold all of your round wire tying devices when you entered into this transaction in 1938, is that correct? A. Yes, yes.

Q. Have you devoted any time to developing any round wire devices after that date? A. No.

(Testimony of Leo M. Harvey.)

Q. When did you first start to work on a flat wire tying device?

A. My recollection is some time in 1927, 1927 or 1928, just about.

Q. Do you recall when you got your first patent for a flat wire tying machine?

A. No, but I can identify it if I look at this agreement here.

Q. All right, look over that if that would help you.

A. Well, here is one on July 17, 1928, looks like the earliest. [116]

Q. And when did you first give someone a right to operate under this patent, under a royalty arrangement?

A. I believe that was given to the predecessor of the Gerrard Company, who called themselves the Tying Machines Company, and then the Garrard Company bought them out, so the agreement was finally worked out, and we had received a royalty of \$15,000.00 on the foreign flat-band patent, and \$15,000.00 a year for the domestic.

Q. Was that before or after they had the right to operate under the round wire device patent?

A. After that.

Q. Now, I am not talking about the wire patents. I am talking about the other patent devices that you have. Did you sell any of those? A. No.

Q. You developed some washing machine patents, did you not?

A. Yes, but I didn't sell them.

(Testimony of Leo M. Harvey.)

Q. What did you do with them? Did you sell them out? A. No.

Q. You still own them? A. Yes.

Q. Do you get any royalties from them?

A. No.

Q. Did you ever get any patents on the food cutting device? [117]

A. I told you we got a patent on a clipper for cutting oranges.

Q. Do you still own that?

A. Well, that patent expired years ago.

Q. You also got a patent on some paper towel dispensers? A. Right.

Q. Do you still own that? A. Yes.

Q. Did you give anyone a right to operate under that?

A. Yes. The concern that operates under those patents owns them. The title is really in that company.

Q. You mean you transferred those patents to that corporation? What is the name of it?

A. Harcraft Company.

Q. What did you do, transfer the shares of stock?

A. I don't know exactly how it was. I don't remember. I didn't get any money, and I don't remember how it was.

Q. Well, in any event, you transferred the patents to that corporation? A. That is right.

Q. And in all probability, you got a consideration of them, you would not transfer the patents if

(Testimony of Leo M. Harvey.)

you didn't either get some stock or something for it? [118]

A. That is right, yes, sir.

Q. Did you ever transfer any other patent?

A. Well, that is pretty hard for me to answer. You see, it goes back over a long period of time, and I can't give you a reasonable answer.

Q. Now, you stated that you paid Lawrence Harvey a sum of money out of each of these \$40,000.00 payments you received.

A. Yes, sir.

Q. How much did you pay him, do you recall?

A. \$8,000.00, that was the 20 per cent arrangement, the arrangement was for him to have 20 per cent of the \$40,000.00, whenever I would get it I would pay him \$8,000.00 per year.

Q. Did you pay him any cash pursuant to the agreement made in April of 1938?

A. I don't remember the date of the agreement. I don't remember at this time.

Q. That is Mr. Lawrence Harvey, is he your son?

A. Yes, sir.

Q. How old was he in 1938?

A. Let me figure it out. He was about 28, or something like that.

Q. Was there ever any agreement between you and him prior to the date of the sale, that he would have any interest in the patent? [119]

A. Yes, provided he makes the deal, that he must come out to make the deal with the American Wire and Steel Company, and the U. S. Steel Com-

(Testimony of Leo M. Harvey.)

pany; if he is to make the deal he will get it, whatever I received he will get a percentage from.

Q. Was the agreement in writing?

A. No, nothing reduced to writing, but we just had—a contract was signed up after that to reduce it to writing.

Q. Did you have any other attorney working with you in connection with this deal?

A. Yes, we did. We had the tax attorney working with the deal.

Q. What was his name?

A. Max Schlesinger.

Q. Max Schlesinger, tax accountant? Do you know what amount he got?

A. That I don't remember.

Q. Did you also employ an attorney?

A. Some other member by the name of Rubin, as I recollect.

Q. Did you employ Walter Sheldon?

A. Yes.

Q. In 1938? A. Yes.

Q. Do you know what his connection was with the deal, [120] if any?

A. He advised how to handle it.

Q. Do you remember what you paid him?

A. No, I don't remember.

Q. Does the figure of approximately \$11,000.00 sound familiar at all?

A. Well, I don't know. I can't answer that.

Q. Do you have your records here so you could

(Testimony of Leo M. Harvey.)

make reference to them and ascertain what you paid him? A. No, I have no records.

Q. Mr. Harvey, you also, I believe, stated that it was your opinion that these round wire patents had no value, or a very small value, what was it you said?

A. Well, I didn't say no value. I said that they are no great intrinsic value, because you got to understand what a patent is, and a patent is not, so far as is it a patent, or what the patent consists of, and some patents are only improvements on a principle which is already in existence. Those patents are not of much value, because they are not basic patents.

Q. As I recall, you referred in your cross-examination to basic patents, and you stated one of the differences was that if there should be some conflict between the operation under your flat wire tying device, and the round wire, did you mean by that?

A. No, sir, there is not. That is an entirely different thing.

Q. Is the flat wire used to hold a box?

A. Really they both work an iron band around there, and it is a very easy matter to make a seal to hold it—can I change my—

Q. Sure. You go right ahead and explain the difference in the two.

A. The object of this round wire and flat wire is the same, is to hold the box together, but the most distinctive feature between the two is to create a seal to hold it together so it won't come apart. On

(Testimony of Leo M. Harvey.)

the round wire to make a seal is very easy, there isn't anything to it, it is just twisted. That is why people can all get in the round wire business, but it is different in the flat band. People who are in the flat business don't nail off the wire.

Q. You stated, I believe, in your direct examination that the Gerrard Company took care of certain patents, the expenses? A. Yes, sir.

Q. Will you state to the Court what patents they were related to?

A. They related to the foreign patents. All the expenses of filing applications for the foreign patents, they paid them. [122]

The Court: In other words, you obtained the basic patents, and they obtained the foreign patents, is that the idea?

The Witness: Yes. I paid all of the money to create the patents, and they took out the same patents in foreign countries.

Q. (By Mr. Tonjes): Were you familiar with the phraseology in this contract of March 21, 1938?

A. I am.

Q. I ask you to take a look at page 4 of that contract, where it has a reference to—about the middle of the second paragraph there, applications and inventions, do you remember that portion of it?

A. Yes, I do.

Q. Do you know what prompted the insertion of that in that?

A. Well, you see, they didn't know, they didn't want to go to the trouble to examine the records,

(Testimony of Leo M. Harvey.)

so I volunteered to repay them, under that particular paragraph.

Q. Can you recollect any expenses under that particular paragraph which might have been given back?

A. I don't recall. There is nothing here that I remember.

Q. I wish you would try to recollect, Mr. Harvey, the [123] nature of the services performed for you by Walter Sheldon, and approximately the fee paid to him.

A. I can look it up in the records, and I can bring it in to you. I wouldn't want to hazard a guess now to make a misstatement of facts.

Q. Did Lawrence Harvey do any work in promoting this sale, for instance, did he act as a salesman, or contact man, or something of that sort?

A. Well, I don't know what you would call it.

Q. Just what did he do?

A. Oh, he talked to the people in the different businesses, he knows his business the same as I do mine. He had to watch the deal, because we were doing business with strangers. I don't believe there was any question but what he tended to his work.

Q. Well, you must have had some general fee in mind, as to how much he would get paid for it, isn't that right?

A. Yes.

Q. It is usual amongst lawyers to find out, in any event, and I imagine you gave him some definite instructions. What did you tell him to do?

A. To make a deal.

(Testimony of Leo M. Harvey.)

Q. In his capacity as a lawyer, to draw the contract?

A. No, in his capacity as a lawyer to help decide things. He is supposed to be a graduate in business administration. [124]

Q. Does he know all about the patent?

A. Yes, he knows about the patent, but I didn't use him as a patent attorney.

Q. Did he ever represent you in any business negotiations before that? A. Yes, he did.

Q. Did he represent you when you were selling patents?

A. No, I wouldn't say that, because we had Mr. Sheldon representing us.

Q. What was the nature of the service that he performed for you?

A. Well, he negotiated with people.

Mr. Tonjes: This is off the record.

The Court: Off the record.

(Discussion off the record.)

The Court: On the record.

Mr. Altman: We will stipulate that Mr. Leo M. Harvey in 1938 paid to Mr. Walter Sheldon \$22,500.00, that he deducted the said sum on his income tax return for that year; that it represents legal fees paid to Walter Sheldon, an attorney in San Francisco, for his services, including the protection of a manufacturer's license agreement which had been granted to the Gerrard Company, a corporation, by Mr. Leo M. Harvey, who was the sole owner of said patent. [125]

(Testimony of Leo M. Harvey.)

Mr. Tonjes: All right.

Mr. Altman: The parties stipuate to that.

Q. (By Mr. Tonjes): Mr. Harvey, I believe you stated that during the various years from 1932 until you sold the patents in 1938, you received minimum royalties of \$30,000.00 a year?

A. Right.

Q. And you reported that on your income tax returns for those years? A. I believe I did.

Q. Could you tell me where that is reflected in your return, that is, your return for 1937?

A. I am not prepared to answer that, because I very seldom read those returns, and I don't very well understand them. I want to answer the truth.

Mr. Tonjes: Yes, we appreciate that, Mr. Harvey. If your Honor please, respondent offers in evidence the return identified by the petitioner as being his income tax report for the year 1937. Incidentally, I will say this is not a return for any of the years before the Tax Court in this proceeding, but respondent offers it for the purpose of showing that the petitioner reported the \$30,000.00 which he received as royalty in the manner set forth in the return.

The Court: Any objection?

Mr. Altman: Could the reporter read that back, please?

(The remark was read.) [126]

Mr. Altman: No objection, your Honor.

The Court: It is admitted, Respondent's Exhibit

A. Do you want to substitute a photostatic copy?

(Testimony of Leo M. Harvey.)

(The document above referred to was received in evidence and marked Respondent's Exhibit A.) [127]

* * * * *

Q. (By Mr. Tonjes): Mr. Harvey, I believe you testified that the amounts of royalties received by you were all accounted for on your books or in your income tax returns?

A. I believe they were.

Q. When did you first start receiving that royalty of a \$30,000.00 minimum?

A. Sometime in 1930, if I recollect correctly.

Q. 1930? A. Yes, sir, 1930 or 1931.

Q. And did that income come to you from a contract with the Gerrard Company?

A. That is right.

Q. Did you have a written contract covering the license agreement? A. Yes, I did. [128]

Q. Do you have a copy of that here?

A. I don't think I have it with me.

Q. Did you have more than one contract covering those items?

A. Yes, we had two contracts, one covering the foreign flat band, and one covering what we called the domestic flat band.

Q. All for the flat band?

A. That is right.

Q. No contract covering the round band?

A. Yes, we had a contract, but it was not any royalty contract.

(Testimony of Leo M. Harvey.)

Q. What was the nature of the contract?

A. Which one?

Q. The one related to the round wire.

A. Manufacturing the articles for them.

Q. And that was with the Gerrard Company too?

A. Yes.

Q. Were they entered into at or about the same time?

A. No, before that.

Q. Which one was entered into first?

A. The round wire.

Q. Now, I show you your income tax return for 1931, Mr. Harvey, and ask you if you can state whether, in your best judgment, the royalty income is reported on that return? [129]

A. I believe I already told you, when you asked me about the other one, that I did not make out those income tax returns, I could not very well state. In the majority of cases I signed them, and I am ashamed to admit I didn't even read them.

Q. Yes, but you kept books, I presume, or books were kept for you?

A. Yes, sir.

Q. And those books, to the best of your knowledge, reflect the receipt of all the income you received?

A. I believe it did.

Q. And in all probability those returns are made up from the books, is that correct?

A. I believe that was the case.

Q. That would be the normal course of events, I believe, and I presume that happened in your case. Would you say that was true?

A. I think so.

Q. I notice on this return, Mr. Harvey, that you

(Testimony of Leo M. Harvey.)

state that your occupation is proprietor of machine shop, and inventor. A. Yes, sir.

Q. Could you explain how the designation of your business as an inventor appeared on that return?

A. I don't know. I couldn't answer you, because, as [130] I told you, I very seldom read the returns, and I don't know why it is marked inventor, or proprietor of machine shop.

Q. You employed someone to make up your returns, didn't you? A. I did.

Q. You have no reason to believe that anything in this return is inaccurate, have you?

A. I have no reason to believe at all. I don't know.

Mr. Tonjes: The respondent offers the return as identified in evidence. [131]

* * * * * * *

Mr. Altman: I have no objection to the introduction of those returns.

The Court: Admitted, Respondent's Exhibit B.

(The document above referred to was received in evidence and marked Respondent's Exhibit B.)

Q. (By Mr. Tonjes): Would you say also, Mr. Harvey, to the best of your knowledge and belief, that income from royalties is properly reflected in your return for 1932? A. 1932?

Q. That is the return I am just presenting to you.

(Testimony of Leo M. Harvey.)

A. This one here. This is marked "Machine Shop," it is not marked inventor here. Has that anything to do with it?

Q. No, I am just asking you whether or not——

A. That is my signature. I signed it.

Q. And you believe that the income that you got from the royalties is shown in there in some way or other?

A. I believe so, yes.

Mr. Tonjes: Respondent offers the return for 1932 in evidence, your Honor.

The Court: Admitted, Respondent's Exhibit C.

(The document above referred to was received in evidence and marked Respondent's Exhibit C.)

Mr. Tonjes: And would you say the same for 1933?

The Witness: That is my signature. [132]

Q. (By Mr. Tonjes): Would you say that to your best knowledge and belief——

A. This is my signature. I signed it.

Q. Would you say that to the best of your knowledge and belief the \$30,000.00 is properly accounted for in this return?

A. Yes, I think so.

Mr. Tonjes: Respondent offers the return for 1933 in evidence.

The Court: Admitted, Respondent's Exhibit D.

(The document above referred to was received in evidence and marked Respondent's Exhibit D.)

(Testimony of Leo M. Harvey.)

Q. (By Mr. Tonjes): I now show you a return for 1934, Mr. Harvey, and ask you, to the best of your knowledge, whether the \$30,000.00 minimum royalty received from the wire patents is accounted for in the return?

A. This is my signature, and I signed it. I presume the same answer would be that I made to the other.

Mr. Tonjes: Respondent offers the return for 1934 in evidence.

The Court: Admitted, Respondent's Exhibit E.

(The document above referred to was received in evidence and marked Respondent's Exhibit E.) [133]

Q. (By Mr. Tonjes): Would you say the same for 1935, Mr. Harvey?

A. That is my signature, and that is the same answer as I made to the other one.

Q. Your answer would be the same?

A. Yes.

Mr. Tonjes: Respondent offers in evidence the return for 1935.

The Court: Admitted, Respondent's Exhibit F.

(The document above referred to was received in evidence and marked Respondent's Exhibit F.)

Q. (By Mr. Tonjes): Will you say the same for 1936?

A. This is my signature, and the same as for 1936.

(Testimony of Leo M. Harvey.)

Mr. Tonjes: Respondent offers the return for 1936.

The Court: Admitted, Respondent's Exhibit G.

(The document above referred to was received in evidence and marked Respondent's Exhibit G.)

Mr. Altman: Your Honor, I wonder if the record may show that by failing to object to the introduction of these returns, I am not in any way agreeing to their materiality.

The Court: The record may show that if you desire it.

Mr. Tonjes: If your Honor please, 1938 is the year [134] in which the transaction took place which we have in controversy, and whether or not the income arising from this sale is reportable on the installment basis; I think it might be helpful to the Court to put this return in evidence, in order to show how the transaction was handled, and then I expect to offer the returns for 1939, 1940 and 1941, which are the taxable years in controversy, and in view of the fact that royalty payments for the years prior to 1938 are in evidence, it may just complete the record, although I do not think it is too important. With that statement I offer the return of the petitioner for the year 1938.

Mr. Altman: No objection.

The Court: Admitted, as Respondent's Exhibit H.

(Testimony of Leo M. Harvey.)

(The document above referred to was received in evidence and marked Respondent's Exhibit H.)

Mr. Tonjes: I may add that there is an original and amended return there, your Honor, which I would like to have as one exhibit.

The Court: One exhibit, all right.

Mr. Tonjes: Now, I will offer the return of Mr. Leo M. Harvey, the petitioner in this case, for the year 1939, being one of the years here in controversy.

The Court: Admitted, as Respondent's Exhibit I.

(The document above referred to was received in evidence and marked Respondent's Exhibit I.) [135]

Mr. Tonjes: I make the same offer for the year 1940.

The Court: Admitted, Respondent's Exhibit J.

(The document above referred to was received in evidence and marked Respondent's Exhibit J.)

Mr. Tonjes: And the same offer for the year 1941.

The Court: Admitted, Respondent's Exhibit K.

(The document above referred to was received in evidence and marked Respondent's Exhibit K.)

* * * * *

(Testimony of Leo M. Harvey.)

Q. (By Mr. Tonjes): Mr. Harvey, I show you what purports to be your income tax return for the year 1938, and ask you if you can identify the signature appearing thereon as your signature?

A. Yes, I did. That is my signature.

Q. I now show you what purports to be the income tax return of Leo M. Harvey, and ask you if that is your signature?

The Court: What year is that?

Mr. Tonjes: 1939. [136]

Q. (By Mr. Tonjes): Whether that is your signature, and that is your tax return?

A. That is my signature.

Q. I now show you what purports to be an individual income tax return for the year 1940 of Leo M. Harvey, and ask you if that is your signature on that document?

A. Yes, sir, this is my signature.

Q. Now I show you what purports to be the income tax return of Leo M. Harvey for the year 1941, and ask you if that is your signature appearing thereon?

A. That is my signature. [137]

* * * * *

Redirect Examination

By Mr. Altman:

Q. Mr. Harvey, you were asked on cross-examination whether you had transferred patents to the Harcraft Company, and you answered that you did. Did you receive any consideration of any kind for that transfer?

A. None.

(Testimony of Leo M. Harvey.)

Q. How much stock do you own in the Harcraft Company? A. About 50 per cent.

The Court: Well, these patents were not paid for in stock?

The Witness: No, your Honor.

Q. (By Mr. Altman): Mr. Harvey, on the direct examination you made some statement in connection with the transaction represented by [138] Exhibit 1, that is the sale to Gerrard in 1938. Did you receive some advice in connection with the income tax—what, if any, income tax problem was that?

A. The income tax problem involved at that time was whether the money that I would receive from the Gerrard Company for the sale of those patents would be ordinary income or a capital gain, and then in discussing the matter with an attorney by the name of Bye, for the Steel Company, he says, "The best thing for you to do is take the question up in Washington direct with the Treasury Department, present your case and show them the contract, and get their final word on it, and I believe it is positive that it will be construed as capital gain."

Q. Did this income tax conversation have to do with your income tax, with your contract with Lawrence Harvey? I mean the contract under which you were to pay Lawrence Harvey 20 per cent.

A. Well, indirectly it did, because it was my understanding that the money Lawrence will re-

(Testimony of Leo M. Harvey.)

ceive should be ordinary income, while the money I would get was a capital gain.

Q. Well, did you expect to save any income tax by paying Lawrence these amounts?

A. No, no, because I figured that he would lose money by doing it, because his, as a capital gain it would be in a [139] smaller bracket.

Mr. Altman: If your Honor please, counsel and I have agreed upon a computation in that respect, showing exactly what the difference was involved, and showing that the taxes paid on Lawrence Harvey's return were much greater than the reduction in taxes in Mr. Leo M. Harvey's return, and I should like to offer that in evidence as Petitioner's Exhibit 2.

Mr. Tonjes: That is objected to.

The Court: If it is stipulated, why make it an exhibit?

Mr. Tonjes: It is not stipulated, your Honor. We were asked to stipulate, but I did not put the document in the form of a stipulation because I want to object to it, on the ground it is wholly immaterial what the tax effect would have been had Mr. Harvey done this, that or the other thing. As I see it, it is entirely immaterial. It certainly does not in any way give Mr. Lawrence Harvey or Mr. Leo Harvey, or anybody else, any rights in any of these patents, and what the tax effect would have been had the transaction, or any part of it, taken a different form, as I say, is entirely immaterial.

The Court: To what extent is that material?

(Testimony of Leo M. Harvey.)

Mr. Altman: It goes, if the Court please, to the agreement between Mr. Leo Harvey and his son, Lawrence Harvey, [140] with respect to this service.

The Court: You make an objection as to the materiality. Are you agreeing in any respect whatever as to this document he is offering in evidence?

Mr. Tonjes: Yes, I agree, your Honor, that the figures shown thereon are correct.

The Court: Very well, it may be admitted as Petitioner's Exhibit No. 2, simply for the purpose of showing that fact.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 2.)

Q. (By Mr. Altman): Mr. Harvey, in the course of this examination you made a statement that your contract with Lawrence Harvey was reduced to writing after the transaction with Gerrard. I show you a copy taken from my own file of what purports to be your agreement. Will you say whether this is a true copy of that agreement?

A. I believe it is. This is a true copy of the agreement that I made with Lawrence on April 2, 1938.

Mr. Altman: I should like to offer that as Petitioner's Exhibit 3.

Mr. Tonjes: No objection.

The Court: Admitted.

(The document above referred to was received in evidence and marked Petitioner's Exhibit No. 3.) [141]

PETITIONER'S EXHIBIT No. 1

* * * * *

It is understood and agreed that the aforesaid U. S. patents, U. S. patent applications and inventions in the round wire and flat band strapping fields only and the aforesaid foreign patents, foreign patent applications and inventions in the flat band strapping field only hereinabove referred to as being owned by first party and limited as aforesaid include not only patents, patent applications and inventions owned by first party, but also patents, patent applications and inventions, if any, owned by Herbert Harvey and in which either or both first party and said Herbert Harvey have an interest, and first party agrees that with respect to all said patents, patent applications and inventions, if any, owned by or in which Herbert Harvey has an interest, first party will cause said Herbert Harvey to execute and deliver all instruments and to do all acts and things which first party has herein agreed to execute and deliver and do with respect to patents, patent applications and inventions owned by first party.

* * * * *

[Endorsed]: Admitted in evidence Nov. 8, 1946.

PETITIONER'S EXHIBIT NO. 2

If (1) the payments by petitioner Leo M. Harvey to Lawrence A. Harvey referred to in paragraph 5-C-1 of the petition were eliminated from the gross income of said Lawrence A. Harvey, and (2) a like amount was restored to the net income of petitioners Leo M. Harvey and Lena P. Harvey, and (3) the gains derived from the sale of patents referred to in paragraph 5-A-1 of the petition were treated as capital gains, and (4) the said capital gains were divided between short term and long term on the basis of the same percentages as those used by the petitioners on their returns (7.292% to assets held eighteen months or less and 92.708% to assets held more than twenty-four months), then

The resulting aggregate additional tax for each year of Leo M. Harvey and Lena P. Harvey, the resulting reduction in tax for each year of Lawrence A. Harvey, and the net resulting reduction in the aggregate taxes of Leo M. Harvey, Lena P. Harvey and Lawrence A. Harvey for each year would be as follows:

Year	Additional Tax Leo M. & Lena P. Harvey	Reduction in Tax— Lawrence A. Harvey	Net Reduction in Tax—
			Leo M. Harvey, Lena P. Harvey and Lawrence A. Harvey
1938.....	\$ 469.42	\$1,128.13	\$ 658.71
1939.....	692.60	657.64	(34.96)
1940.....	1,422.68	2,017.31	594.63
1941.....	1,492.00	4,340.80	2,848.80
<hr/>			
Total	\$4,076.70	\$8,143.88	\$4,067.18

[Endorsed]: Filed Nov. 8, 1946. [143]

PETITIONER'S EXHIBIT NO. 3

Lawrence A. Harvey
Attorney and Counselor at Law
6200 Avalon Boulevard
Los Angeles, California

April 2, 1938.

To Leo M. Harvey, dr.

For good and valuable services in aiding and assisting in the negotiation and the drafting and preparation of contracts and notes in connection with the sale of the Gerrard patents and agreements on wire tying business to The Gerrard Company, Inc. and the American Steel & Wire Company, you are to pay me Twenty (20%) Per Cent of all proceeds of such sale as received by you.

Your signature will constitute your agreement.

/s/ LAWRENCE A. HARVEY.

I hereby agree to the above

/s/ LEO M. HARVEY.

[Pencil Notation]: Patent.

[Endorsed]: Filed Nov. 8, 1946. [144]

The Tax Court of the United States
Dockets No. 7116 and 7117

LEO M. HARVEY and LENA P. HARVEY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DESIGNATION OF CONTENTS OF RECORD
ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit, and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit copies (or originals where indicated) duly certified as correct of the following documents and records in the above-entitled causes in connection with the petition for review heretofore filed by the petitioners:

1. The docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court, as follows:

- (a) Petition (in Docket No. 7116 only).
- (b) Answer (in Docket No. 7116 only).
- (c) Amendment of petitions embodied in motion to amend them, filed September 6, 1946, and granted October 9, 1946.
- (d) Amendment of petitions embodied in motion to amend them, filed and granted November 4, 1946.

- (e) Answer to petition as amended, filed November 8, 1946.
- (f) Answer to amendment to petition, filed November 8, 1946.

3. Motion for Judgment on the Pleadings, filed April 2, 1945, and denied May 17, 1945 (in Docket No. 7116 only). [147]

4. The findings of fact and opinion of the Tax Court.

5. Motion for rehearing.

6. Order entered April 29, 1947, amending findings of fact and opinion and denying motion for rehearing.

7. The decisions of the Tax Court.

8. The petition for review.

9. All of the official transcript of oral testimony of the hearing November 8, 1946.

10. All of the exhibits, including copies of petitioners' exhibits 2 and 3, and the originals of all the other exhibits.

11. This designation of contents of record on review.

The pleadings and other papers filed separately in Docket No. 7117 are omitted for the reason that they are identical in all material respects, except as to name of petitioner, with corresponding pleadings and other papers in Docket No. 7116. Inclusion of the pleadings or other papers in Docket No. 7117 would in consequence constitute mere duplication.

With respect to items 9 and 10 above petitioners

quote as follows from a letter received from respondent dated October 31, 1947:

“If you do not wish to go up on the pleadings and the memorandum findings of fact and opinion and decisions of the Tax Court, it would seem, in view of the nature of the questions involved, that a complete record is necessary and that in your designation of contents of record on review you should therefore also call for the transcript of the hearing and the exhibits.”

Dated: November 20, 1947.

/s/ GEORGE T. ALTMAN,
Attorney for Petitioners.

Personal service of a copy of the foregoing designation is hereby acknowledged as having been made this 24th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel, Bureau of
Internal Revenue.

Filed November 25th, 1947. [149]

[Title of Tax Court and Causes.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States, do hereby certify that the foregoing pages, 1 to 149, inclusive, contain and are a true copy of the transcript of record, papers, and

proceedings on file and of record in my office as called for by the Praeceptum in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 15th day of December, 1947.

EMJ

[Seal] /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the
United States.

[Endorsed]: No. 11823. United States Circuit Court of Appeals for the Ninth Circuit. Leo M. Harvey and Lena P. Harvey, Petitioners, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed January 2, 1948.

 /s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

11823

T. C. Docket Nos. 7116 and 7117

LEO M. HARVEY and LENA P. HARVEY,
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

MOTION FOR ENLARGEMENT OF TIME IN
WHICH TO FILE TRANSCRIPT OF
RECORD

Come Now the petitioners in the above-entitled proceeding, by their counsel of record, and request an enlargement of 40 days in which to file the Transcript of Record. The reason for the enlargement is that the time otherwise allowable would expire November 26, 1947, and the time so far elapsed has been lost in an attempt, which has not proved successful, to reach an agreed statement under Rule 76 of the Rules of Civil Procedure.

Respondent has stated that he will have no objection to the granting of this motion.

Wherefore, it is prayed that this motion be granted.

/s/ GEORGE T. ALTMAN,

Attorney for Petitioners on
Review.

State of California,
County of Los Angeles—ss.

George T. Altman, being duly sworn, deposes and says: that he is attorney for petitioners on review in the above-entitled matter; and that the facts stated in the foregoing motion are true and correct.

/s/ GEORGE T. ALTMAN.

Sworn and subscribed to before me this 14th day of November, 1947.

/s/ BEN H. RUDNICK,

Notary Public in and for Said
County and State.

[Endorsed]: Filed Nov. 18, 1947; re-filed Jan. 2, 1948.

So Ordered:

/s/ FRANCIS A. GARRECHT,

Senior United States Circuit
Judge.

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 11823

LEO M. HARVEY and LENA P. HARVEY,
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

STATEMENT OF POINTS ON WHICH
PETITIONERS INTEND TO RELY

Come Now the petitioners in the above-entitled proceeding, by their counsel of record, and, for the purpose of statement of points on which they intend to rely, assign as error the following acts or admissions of the Tax Court:

1. Denial of motion for judgment on the pleadings.
2. Failure to hold that the amount, or any portion of the amount, received each year on the Gerrard notes was an amount received on the sale of "capital assets" as that term is defined in Section 117(a)(1) of the Internal Revenue Code.
3. Failure to find that the flat band patents sold to Gerrard were not property used in the trade or business of a character which is subject to the allowance for depreciation.

4. Failure to allow either as offsets or deductions the amounts paid Lawrence A. Harvey and Herbert Harvey, or any portion thereof.

5. Finding of deficiencies for the years involved instead of overpayments as requested.

/s/ GEORGE T. ALTMAN,

Counsel for Petitioners on
Review.

Dated: January 7, 1948.

[Endorsed]: Filed Jan. 8, 1948.

No. 11823

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LEO M. HARVEY and LENA P. HARVEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONERS.

GEORGE T. ALTMAN,

215 West Seventh Street, Los Angeles 14,

Attorney for Petitioners.

FILED

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No. 11823

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LEO M. HARVEY and LENA P. HARVEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPENING BRIEF FOR PETITIONERS.

JURISDICTION.

The jurisdiction of this Court is invoked under Section 1141(a) of the Internal Revenue Code. Petitioners are residents of Los Angeles, California.

ISSUES PRESENTED.

The controversy involves a proper determination of the petitioners' liability for federal income taxes for the calendar years 1939, 1940 and 1941. The issues are:

1. Whether the gain realized by petitioners on account of the installment sale of certain patents constituted capital or ordinary gain.

2. Whether certain portions of the sales price paid by petitioners to others can properly be excluded from or offset against the sales price received, and whether in that connection the Tax Court should have granted petitioners' motion for rehearing.

3. Whether the Tax Court should have granted petitioners' motion for judgment on the pleadings.

STATEMENT.

The following statement is drawn from the Tax Court's findings of fact, from the evidence and from other parts of the record. The evidence is cited, not in derogation of the findings, except where so expressly stated, but in supplement thereto. Petitioners request remand, if necessary, for the purpose of obtaining findings covering the evidence so cited.

General Facts.

1. Petitioners are husband and wife residing in Los Angeles. They filed separate returns for the taxable years on a community and accrual basis [R. 43]. Unless otherwise indicated, the term "petitioner" in the singular will hereinafter be used to refer to petitioner Leo M. Harvey.

Facts Relative to Issue No. 1.

2. By written agreement dated March 21, 1938, petitioner sold certain patents and applications for patents, both foreign and domestic, to the Gerrard Company, Inc., hereinafter referred to as "Gerrard." The patents so sold by petitioner covered inventions in the round wire tying and the flat band strapping and tying fields. Gerrard paid petitioner as consideration \$25,000 cash upon execution of the agreement and delivered to petitioner 10 negotiable promissory notes, each in the amount and each having then a fair market value of \$40,000, all dated April 2, 1938, numbered 1 to 10, inclusive, and maturing serially commencing April 2, 1939, and thereafter on April 2 of each succeeding year through April 2, 1948. These notes were tendered and accepted as payment. During the taxable years here involved these notes were paid when due [R. 43].

3. While the patents sold included patents in the round wire as well as the flat band field, the entire value represented by the proceeds of the sale was in the flat band patents [R. 71-73, 105]. This value resulted from a minimum royalty of \$30,000 per year which Gerrard was obligated to pay petitioner under license contracts covering the said flat band patents [R. 71-73].

4. There were no royalties paid on the flat band patents other than the minimum royalties above referred to [R. 73]. There was no royalty contract covering the round wire patents [R. 73, 91-102].

5. Petitioner, since about 1914, had been sole proprietor of a business known as Harvey Machine Company. This business consisted primarily of making industrial machinery on special order [R. 45]. Petitioner commenced developing inventions in the wire-tying field in the middle 1920's, and subsequent thereto and from time to time obtained the patents sold to Gerrard [R. 45]. The expense of developing these inventions was deducted as business expense of Harvey Machine Company [R. 45].

6. Some time in 1930 petitioner licensed Gerrard to operate under certain of the flat wire tying patents at a minimum royalty of \$30,000 a year (referred to above in paragraph 3), which petitioner received from 1931 to 1937, inclusive. In 1938 and by the terms of the sales contract Gerrard agreed to pay petitioner certain amounts on account of royalties due up to and including March 31, 1938. The royalty payments received by petitioner prior to 1938 were reported by petitioner as income from the business of Harvey Machine Company [R. 45-46, 57].

7. Under the license contracts covering the flat band patents petitioner made only the first finished models. That

was sometime in 1930 or 1931 [R. 82]. After that his only work in connection with those patents was to complete applications and improvements in process [R. 82-83]. None of such work, however, continued into the last two or two and one-half years prior to the sale of the patents on March 21, 1938 [R. 83]. Except for the first finished models, made by him in 1930 or 1931, petitioner never made any machine covered by the said patents [R. 83].

8. The said flat band patents were wholly unrelated to petitioner's business, and were wholly unrelated to the patents in the round wire field. In that respect petitioner testified, without controversion, as follows:

A. On direct examination—

“Q. Were these flat band patents in any way pertinent to or necessary to or were they in some way involved in the business which you were carrying on in the last two or three years or so prior to that transaction? A. We never used the patent because we never made the machines.

Q. Referring to the wire machine or wire tying trade, are round wire and flat wire or slot band wholly different fields of production? A. Yes, they are” [R. 83].

“Q. Did the flat band patents have any relation in any respect to the round wire patents? A. None, because they are an entirely different art” [R. 69].

B. On cross-examination—

“The object of this round wire and flat wire is the same, is to hold the box together, but the most distinctive feature between the two is to create a seal to hold it together so it won't come apart. On the round wire to make a seal is very easy, there isn't anything to it, it is just twisted. That is why people

can all get in the round wire business, but it is different in the flat band. People who are in the flat business don't nail off the wire" [R. 105-106].

9. Petitioner sold his wire-tying patents to Gerrard for the purpose of raising capital in order to branch out into larger business [R. 68].

10. Petitioner was not in the business of selling patents. Other than the patents involved here he never sold any patents to anyone. He never held any patents for the purpose of selling them [R. 81]. The sale of the patents involved here was not to a mere customer but to a person which already, and since 1930, had the use of the patents, and under a license obligating it to pay petitioner a minimum royalty of \$30,000 per year [R. 45-46].

Facts Relative to Issue No. 2.

11. By written agreement and under circumstances hereinafter described petitioner paid his son Lawrence 20 per cent of the proceeds of the sale as received by petitioner. Petitioner also paid certain amounts to his brother Herbert from such proceeds. Herbert was thus paid \$2,500 in each of the taxable years here involved [R. 43-44].

12. Petitioner's son, Lawrence, was an attorney about 28 years old in 1938. He assisted petitioner in *negotiating* the sales contract with Gerrard [R. 44]. Petitioner engaged Lawrence for this purpose [R. 107], instructing him to "make a deal" [R. 103-104, 107], and agreeing in advance to compensate him if he succeeded [R. 103-104]. After a deal was completed, the compensation agreement was reduced to writing [R. 104, 123]. Under said written agreement, dated April 2, 1938 (the very same day that the sale was completed—see paragraph 2 above), peti-

tioner agreed to compensate Lawrence for his efforts in connection with the sale of the patents by paying him 20 per cent of all proceeds of the sale as received by petitioner. Under this agreement petitioner paid Lawrence \$8,000 a year during the taxable years [R. 44-45, 120, 123].

13. Petitioner employed as attorneys in connection with the Gerrard deal, Max Schlesinger, who handled the tax aspects, one Rubin and a Walter Sheldon* [R. 44-45].

14. Before completing the sale of the patents to Gerrard petitioner sought tax advice and was advised that under the law the gain on the sale was capital gain [R. 118-119]. He believed also that since the payments to Lawrence would be ordinary income to Lawrence, while they would only reduce his own capital gain, there would

*The Tax Court states in its findings [R. 45] that petitioner "also" employed as attorneys the three individuals named. The apparent implication is that he employed Lawrence as attorney. The fact that Lawrence was an attorney does not, of course, require the conclusion that his services in the Gerrard deal were as attorney, or solely as attorney. On the contrary, the Court itself in its findings with respect to Lawrence's services says only that Lawrence assisted petitioner in "negotiating" the sales contract with Gerrard. [R. 44.] The evidence amply supports this finding and shows also that Lawrence's principal efforts were as negotiator, not as attorney. [R. 107, 108—cross-examination.] Perhaps the Court used the word "also" inadvertently or did not intend the implication above mentioned.

With respect to Walter Sheldon the Tax Court in its findings [R. 45] added:

"Walter Sheldon was paid \$22,500 in 1938 for his services, which services among others concluded Sheldon's work in connection with the Gerrard sale."

There is nothing anywhere in the evidence to support the implication apparent in the word "concluded" that Sheldon rendered services in connection with the sale to Gerrard prior to 1938. The evidence, in fact, is clear to the contrary. [R. 104.] Nor was the sale even in petitioner's mind prior to 1938. [R. 68.] Perhaps, however, the Court meant "included" instead of "concluded."

be a net tax loss, to himself and Lawrence combined, because of said payments [R. 119-120]. On the basis of the returns filed by them there was, in fact, a net tax loss of \$4,067.18 for 1938 and the taxable years here involved [R. 120-122].

15. Petitioner's brother, Herbert, had been an employee of petitioner, in connection with the business known as Harvey Machine Company, since about 1918 on a salary ranging from \$500 to \$1,500 a month [R. 45].

16. Petitioner developed the wire-tying inventions with the advice and assistance of Herbert. He paid Herbert 10 per cent of the \$30,000 annual minimum royalty received by him from Gerrard [R. 46]. From the very beginning, each month that he received a payment from Gerrard, he paid Herbert his percentage [R. 77, 97]. He made these payments to Herbert because he considered Herbert's advice very valuable [R. 97]. In that connection petitioner testified:

"It is not what you do in the daytime in the business, it is what you do in the evening and Sundays and holidays in discussing these matters and advising, I considered was valuable to me" [R. 97].

When the patents were sold petitioner settled with Herbert by agreeing to pay him in lieu of the 10 per cent of royalties, \$2,500 out of each payment of \$40,000 received from Gerrard [R. 77-78]. The sales contract with Gerrard, in which petitioner is referred to as "first party", provided *inter alia*:

"It is understood and agreed that the aforesaid U. S. patent applications and inventions in the round wire and flat band strapping fields only and the aforesaid foreign patents, foreign patent applications and

inventions in the flat band strapping field only hereinabove referred to as being owned by first party and limited as aforesaid include not only patents, patent applications and inventions owned by first party, but also patents, patent applications and inventions, if any, owned by Herbert Harvey and in which either or both first party and said Herbert Harvey have an interest, and first party agrees that with respect to all said patents, patent applications and inventions, if any, owned by or in which Herbert Harvey has an interest, first party will cause said Herbert Harvey to execute and deliver all instruments and to do all acts and things which first party has herein agreed to execute and deliver and do with respect to patents, patent applications and inventions owned by first party" [R. 46, 67-68, 121].

Facts Relative to Issues No. 2 and No. 3.

17. In reporting the proceeds of the sale of these patents for income tax purposes petitioners excluded or deducted from the sales price the said amounts payable to Lawrence and Herbert respectively. The remainder of the sales price was reported on the installment basis and treated as capital gain, each petitioner reporting a community one-half [R. 44].

18. The election to report this sale on the installment basis was made by petitioners in their returns for the year 1938, under Section 44(b) of the Revenue Act of 1938; but otherwise their returns for 1938 were on the accrual basis. (Alleged and admitted in the pleadings. [R. 12, 30.]) Petitioner never regularly sold any property on the installment plan [R. 84].

19. The Commissioner disallowed (a) the treatment of the gain as capital gain, and (b) the exclusion or deduc-

tion of the amounts paid Lawrence and Herbert. The only explanation given therefor in his notice of deficiency to each petitioner is as follows:

“It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income” [R. 21].

20. Petitioners petitioned the Tax Court for a redetermination, alleging as error the treatment of the gain as ordinary income, and the failure to allow the payments to Lawrence and Herbert, either as offsets against the selling price, or as deductions under Section 23(a)(2) of the Internal Revenue Code [R. 11]. Commissioner in his answer [R. 30-31] denied *inter alia* certain negative allegations of petitioners, including the following [R. 15]:

“12. None of said patents were stock in trade of petitioner.

“13. None of said patents were other property of a kind which would properly be included in the inventory of the petitioner if on hand at the close of the taxable year.

“14. None of said patents were held by petitioner primarily for sale to customers in the ordinary course of his trade or business.”

Petitioners made said allegations for the obvious purpose of taking the patents out of the following portion of the exception clause in the definition of “capital assets” in Section 117(a)(1) of the Internal Revenue Code [Appendix herein, p. 3]:

“but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by

the taxpayer primarily for sale to customers in the ordinary course of his trade or business. . . .”

21. Petitioners thereupon filed motion for judgment on the pleadings [R. 39-41], on the ground (a) that the denial by Commissioner of the said negative allegations of petitioner amounted to an allegation by him that the patents did fall within said portion of said exception clause, (b) that a sale of property falling within said portion of said clause could not be a “casual” sale within the meaning of Section 44(b) of the Revenue Act of 1938 [Appendix herein, p. 1] and could not therefore be reported on the installment basis, and (c) that the said denial by Commissioner amounted as a result to an allegation that none of the gain on the sale of the patents was properly reportable in any of the years here involved, the said sale having taken place in 1938.

The Tax Court denied said motion for judgment on the pleadings. Commissioner, however, did not abandon his denial of said negative allegations of petitioners. On the contrary, at the trial, in his counsel’s opening statement, he placed his position in that respect in clear, positive form, as follows:

“Of course, it was an asset held by the Petitioners primarily for sale in the ordinary course of the trade or business. . . .” [R. 67.]

22. After decision by the Tax Court for the Commissioner petitioners filed motion for rehearing [R. 50]. The Court met the first ground of the motion by amending its

findings of fact [R. 56-57]. With respect to the remaining grounds, however, the Court simply denied the motion [R. 57]. The said remaining grounds, in brief, were as follows:

- (a) That the Court in its opinion having considered the value of Lawrence's services as distinguished from the bona fides of his compensation, which alone petitioners had considered in issue, they desired now to call Lawrence as a witness in connection with such value.
- (b) That the Court while finding that Lawrence did render services failed to place any value upon them.
- (c) That the Court's conclusions in respect to Herbert were in conflict with the evidence and that petitioners desired to call Herbert as a witness for the purpose only of avoiding any implication that might have resulted from the fact that he had not been called.

Petitioners attached to the motion affidavits [R. 53-56] showing in substance what the testimony of said witnesses would be if they were called. As above stated, the Tax Court denied the motion. Petitioners then filed their petition for review by this Court.

ARGUMENT.

The gain realized by petitioners from the installment sale of patents to Gerrard in 1938 was capital gain. The statutory provisions in that respect cover all property, subject to specified exceptions. The provisions upon which respondent must rely are thus exception clauses and should be narrowly construed.

The said exceptions are:

1. Stock in trade of the taxpayer,
2. Other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year,
3. Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, and
4. Property used by the taxpayer in his trade or business and subject to the allowance for depreciation.

The patents involved here did not fall within any of the said exceptions. The Tax Court in its opinion stated that the patents were probably not within any of the first three exceptions, but did fall within the fourth. Its conclusion with respect to the first three exceptions is well supported by the facts. Petitioner was not in the business of selling patents. Nor was this sale a sale to a "customer" in the usual sense of that term. Nor did the sale take place in the "ordinary course" of his business.

As to the fourth exception the Tax Court was definitely in error. Under the circumstances of this case, this exception in the definition of capital assets should be narrowly construed and any doubt in its meaning should be

resolved in favor of the taxpayer. The reason is that the application of this exception to these petitioners is prejudicially retroactive, and is not within the intent of Congress.

Nor were the patents in fact used in petitioner's trade or business. For the purpose of this exception provision, use in the trade or business means such use at the time of sale. At the time of sale and for several years prior thereto, petitioner was a mere passive recipient of minimum royalties under a license of the said patents granted by him to Gerrard in 1930. The mere passive receipt of royalties is not in itself a trade or business. Nor is it made a trade or business merely because the property from which the royalties are derived may have originated in the taxpayer's trade or business. This is emphasized here by the fact that the patents were sold for the purpose of raising capital in order to expand the business; and it was to unfreeze capital for that very purpose that Congress enacted the capital gain provisions.

The payments to Lawrence A. Harvey and Herbert Harvey out of the proceeds of the sale should be allowed as an exclusion from or offset against the selling price. For this purpose it is only necessary to show that the payments were *bona fide* and were actually incurred in connection with the sale of the patents. It is not necessary to show that they were ordinary and necessary, or reasonable. The payments to Lawrence were *bona fide* and actually incurred in connection with the sale of the patents. The payments to Herbert were payments for his interest in the patents. In any event, the payments to Herbert were capital expenditures incurred by petitioner in connection with the patents and therefore deductible as offsets against the selling price. The Tax Court concluded that the services of Herbert were invaluable. It certainly therefore should

have allowed the deduction of a mere \$2,500 out of each \$40,000 payment received by petitioner.

In any case, as the Tax Court found, Lawrence and Herbert did render services. As a result, the Commissioner was in error in making no allowance at all. The Tax Court therefore could not, as it did, simply sustain the Commissioner but bore a duty to make a determination as to the value of those services and to allow at least such amount as deductions. To that end, if necessary, the Court should have granted petitioners' motion for rehearing.

Petitioners' motion for judgment on the pleadings should have been granted. A motion for judgment on the pleadings should be granted where a position taken by the opposite party on the facts, if it represented the truth, would require such a judgment and such opposite party fails to amend. The Commissioner in his answer took such a position because he took a position, *inter alia*, that the property fell within the first three exceptions to capital asset classification stated above, and such position is inconsistent with the inclusion in gross income in the years here involved of *any part* of the proceeds of the sale. The Commissioner, furthermore, after petitioners filed motion for judgment on the pleadings, pointing out the defect in his answer, made no attempt to amend. On the contrary, he reaffirmed the said position at the opening of the hearing, in express words. The motion for judgment on the pleadings should therefore have been granted.

POINTS OF LAW.

Issue No. 1: Whether the Gain Realized by Petitioners on Account of the Installment Sale of Certain Patents Constituted Capital or Ordinary Gain.

I.

The Statutory Provisions Upon Which Respondent Must Rely Are Excepting Clauses and Should Be Narrowly Construed.

The respondent's deficiency notice denies to petitioners the treatment as capital gain of the amounts received under the Gerrard contract on the ground that such amounts are "ordinary income." The deficiency notice contains no other description or explanation. The applicable statutory provision, Section 117 of the Internal Revenue Code, is, to the extent pertinent, given in the Appendix, p. 3. The words "ordinary income" appear nowhere in that provision. Those words have merely come to signify any income which is not gain on the sale or exchange of "capital assets."

Coming then to the statutory definition of the term "capital assets", the Committee on Ways and Means has stated:

"It will be noted that the definition includes all property, except as specifically excluded." (Report—Ways and Means Committee, 73d Cong. 2d Sess., House Rept. 704, page 31; 1939-1 C. B. Part 2, p. 577.)

An excepting clause is to be narrowly construed. *U. S. v. Scharton*, 285 U. S. 518, 52 S. Ct. 416. The capital gain

provisions were enacted to make it possible for a taxpayer to dispose of items of investment property without being deterred by the high rates of tax otherwise applicable; for it was found that “an excessive tax on capital gains freezes transactions and prevents the free flow of capital into productive investments.” (Report—Senate Finance Committee, 75th Cong., 3d Sess., S. Rept. 1567, page 6; 1939-1 C. B. Part 2, p. 783.) The capital gain provisions should be interpreted so as to carry out that Congressional purpose. The very purpose of those provisions emphasizes the applicability here of the general rule that an excepting clause is to be narrowly construed.

The Commissioner's notices of deficiency gave the petitioners no notice of the particular exception or exceptions upon which he relied. In his answer, however, by way of denial, the Commissioner placed reliance upon all of them. As the statutory provision shows, there were four such exceptions:

1. “Stock in trade of the taxpayer”,
2. “Other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year”,
3. “Property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business”,
4. “Property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(1)”.

II.

The Patents Involved Were Not “Stock in Trade of the Taxpayer”, Nor “Other Property of a Kind Which Would Properly Be Included in the Inventory of the Taxpayer if on Hand at the Close of the Taxable Year”, Nor “Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His Trade or Business.”

The Tax Court in its opinion stated:

“While it may be doubtful whether the patents involved constituted petitioner’s stock in trade or property of a kind which would properly be included in inventory or property held primarily for sale to customers in the ordinary course of business, . . .”
[R. 46.]

The Court thus took the patents out of the first three statutory exceptions to capital asset classification.

The facts amply support that result. Petitioner was not in the business of selling patents. Other than the patents involved here he never sold any patents to any one. As to the patents involved here, he never held them for sale to any one. The actual sale here, furthermore, was not to a mere “customer.” The vendee, the Gerrard Company, was at that time, and had been since 1930, the exclusive licensee of those patents, and was obligated under the license to pay petitioner a minimum royalty of \$30,000 per year. Nor was the sale in “the ordinary course of business”, since the purpose of the sale was to obtain capital for expansion purposes.

Plainly then the patents involved here were not “stock in trade of the taxpayer.” It must also follow that they were not “other property of a kind which would properly be included in the inventory of the taxpayer if on hand

at the close of the taxable year." The term inventory is applicable only to items "which have been acquired for sale or which will physically become a part of merchandise intended for sale." [Reg. 111, Sec. 29.22(c)-1, Appendix herein, p. 4.] Definitely these patents were not in that category. It must follow, too, that these patents were not "property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business." In *Samuel E. Diescher v. Com.*, 36 B. T. A. 732, the Board stated, at page 743:

"He [the Commissioner] argues that the patents were held by the partnership primarily for sale in the course of its business. As to this, the record discloses nothing, in our opinion, indicating that the partnership has ever been in the business of buying and selling patents or in developing inventions for patent and sale. So far as we know, the patents involved here are the first which the partnership has ever sold, although it has been in business for many years. All of the other transactions having to do with the patents of the partnership have been connected with the licensing of their use. The basic patent involved in the exchange between the partnership and the newly organized corporation, and which represents the largest individual value among the patents and inventions exchanged, had been owned for many years by the partnership. During that time its use by other companies had been granted under license agreements. It is evident that the patents and inventions here in dispute did not constitute stock in trade, held for sale by the partnership in the course of its business."

The Tax Court reaffirmed that view in *Edward C. Myers v. Commissioner*, 6 T. C. 258. To the same effect is *Bessie B. Hopkinson v. Commissioner*, 42 B. T. A. 580, 581, affirmed C. C. A. 2, 126 F. 2d 406.

III.

The Patents Involved Were Not “Property, Used in the Trade or Business, of a Character Which Is Subject to the Allowance for Depreciation Provided in Section 23(1).”

(a) This Exception in the Definition of Capital Assets Should Not Only Be Narrowly Construed; Any Doubt in Its Meaning Should Be Resolved in Favor of the Taxpayer.

(1) The application of this exception in the definition of capital assets to these petitioners is prejudicially retroactive.

This exception was added to the statute under the Revenue Act of 1938, enacted May 16, 1938. The sale involved here, however, took place on March 21, 1938. It is true that retroactive application of income taxes has been held constitutional. This does not, however, remove the possibility that in a particular case such application may be unfair and unjust. Here a taxpayer made a sale in the well grounded belief that the sale was a sale of capital assets. He even sought advice in that respect and received it. His purpose in making the sale, to enable him to obtain capital for productive investment, was of the very kind for which the capital gain provisions were enacted. (Report—Senate Finance Committee, *supra*.) The notes which he received were worth face value at the time received. With such capital he was indeed empowered to expand his operations as he desired.

Only after the transaction was complete and irrevocable was this exception in the definition of capital assets engrafted upon the law. It has been held that tax laws are to be “construed and applied with a view to avoiding,

so far as possible, unjust and oppressive consequences.” 1 Mertens 62. More specifically, it has recently been stated by the Supreme Court: “Retroactivity, even where permissible, is not favored, except upon the clearest mandate The letter does not require this. The consequences forbid it.” *Claridge Apartments Co. v. Com.*, 323 U. S. 141, 164, 65 S. Ct. 172. Here the application sought of a statutory provision is prejudicially retroactive. Under such circumstances the taxpayer is at least entitled to have any doubts resolved in his favor.

(2) The application of this exception in the definition of capital assets to these petitioners is not within the intent of Congress.

In presenting this provision to the floor of the House, the Committee on Ways and Means stated:

“The definition of capital assets is slightly modified so as to exclude from the definition, property used in the taxpayer’s trade or business, which is subject to depreciation allowances. This, in the great majority of cases, should be of benefit to the taxpayer, since it will allow him to take losses against his ordinary income from the sale of such property. Under existing law, if a taxpayer loses on the sale of depreciable property, he can not charge it off against ordinary income and can only receive a deduction if he has capital gains. Moreover, the loss taken into account is reduced according to the length of time during which he has held such property. Under the proposed change, he will be able to charge off the full amount of the loss against his ordinary income.” Report—Ways and Means Committee, 75th Cong. 3d Sess. House Rept. 1860, 1939-1 C. B. Part 2, pp. 728, 732.

The Committee illustrated the operation of the provision as follows:

“Suppose that X, a manufacturer, purchased in 1932 a large machine, at a cost of \$50,000. At the time of acquisition and installment in his plant, the machine had an estimated useful life of 10 years. X was therefore allowed an annual deduction from gross income for depreciation on the straight-line method of one-tenth of the cost, or \$5,000, with respect to this machine. Assume that in 1938, when the machine has been in use for six years, a new and improved type of machine is introduced, the installation of which would materially reduce X’s costs of production. X has, however, recovered only 60 per cent of the cost of the old machine through the annual deduction for depreciation. Let it be further assumed that X could sell the old machine to Y, another manufacturer, for \$7,500, which is only 15 per cent of its cost to X, but is materially in excess of its junk or salvage value. If such a sale were consummated, X would sustain an actual loss of \$12,500 on this machine. The result of section 117(a)1 of the present bill is to allow X to deduct this loss in full from gross income, whereas, but for such provision, section 117(b) would limit X to a deduction of 40 per cent of this amount, or \$5,000, of which not more than \$2,000 could be applied against income other than long-term capital gains.” (*Ibid.*, pp. 752-53.)

The Senate Finance Committee, in presenting this provision to the floor of the Senate, stated:

“The definition of capital assets has been changed, so that depreciable assets are no longer included in the category of capital assets. This change made in the House bill allows a corporation to receive the

full benefit of a deduction for losses on the sale of depreciable assets from its ordinary income.” Senate Report No. 1567, 75th Cong. 3d Sess., 1939-1 C. B. Part 2, pp. 779, 783.

Clearly then it was the intent of Congress in enacting this change in the definition of capital assets to liberalize the definition in favor of the taxpayer because of the inadequacy in certain cases of the allowance for depreciation. Certainly that change was never intended to draw within its scope such property as is here before this Court, in which there is utterly no relation between cost and value, and in which depreciation as a result could never be a significant factor.

(b) The Patents Involved Here Were Not Used in the Taxpayer's Trade or Business.

(1) The determination whether these patents were property “used in the trade or business,” within the meaning of the clause in Section 117(a)(1) of the Internal Revenue Code excepting such property, depends on whether the patents were so used at the time of sale.

In presenting the exception of property “used in the trade or business” to the floor of the House the Committee on Ways and Means stated:

“It should be noted, however, that it is limited to property used by the taxpayer in his trade or business at the time of the sale or exchange . . .”
House, etc. 1939-1 C. B. Part 2, pp. 728, 753.

The same point is made in *R. W. Albright v. U. S.* (D. C. Minn.), 76 Fed. Supp. 532, Mar. 18, 1948, in which rulings of the Commissioner to that effect were sustained.

Under those rulings the Commissioner held that property "used in the trade or business," within the meaning of Section 117 of the Internal Revenue Code, was limited to property so used at the time of its sale; and that therefore livestock acquired by a taxpayer for use in his trade or business, and so used, but later separated out for sale to customers in the ordinary course of his trade or business, was not property "used in the trade or business" for the purpose of Section 117 of the Internal Revenue Code; and the court in the *Albright* case approved those rulings. It is shown also in *B. G. Lurie v. Commissioner* (C. C. A. 9), 156 F. 2d 436, that the definitions in Section 117 are referable to the time of the taxable transaction.

(2) It is immaterial whether the round wire patents were used in petitioners trade or business since the total proceeds of the sale were attributable to the flat band patents, and the flat band patents had no relation to the round wire patents.

The facts show that the entire proceeds of the sale were attributable to the flat band patents. Furthermore, the flat band patents had no relation to the round wire patents. The flat band business was restricted by the flat band patents, but any one could get into the round wire business. It is immaterial therefore whether the round wire patents were used in petitioner's trade or business. The question is solely whether the flat band patents were so used.

(3) In 1938 when petitioner sold his flat band patents to Gerrard he was with respect to such patents a mere passive recipient of minimum royalties under the license granted by him to Gerrard in 1930.

The basic facts in regard to the flat band patents are that: (a) no machines were manufactured by petitioner under them, except for models in 1930 or 1931; (b) from 1931 on those patents were under license to Gerrard at a minimum royalty of \$30,000 per year; (c) no royalty beyond such minimum was ever paid him; (d) his only work in connection with those patents after 1931 was completion of applications and improvements in process; (e) none of even such work continued into the last two or two and one-half years prior to the sale on March 21, 1938; and (f) when petitioner sold them he did so in order to obtain capital with which to expand into larger business.

The conclusion is clear that with respect to these patents petitioner at the time of the sale was a mere passive recipient of minimum royalties under the license granted by him to Gerrard in 1930.

(4) The mere passive receipt of royalties by petitioner was not in itself a trade or business.

In order that anything be classified as a trade or business there must be at least a regularity and continuity of time, attention and labor devoted to carrying it on. *Snyder v. Commissioner*, 295 U. S. 134; *Van Wart v. Commissioner*, 295 U. S. 112; *Higgins v. Commissioner*, 312 U. S. 212. Even the case of *John Fackler v. Com.* (C. C. A. 6), 133 F. 2d 509, upon which respondent will undoubtedly rely, does not deny that. There it was necessary for the taxpayer to "furnish elevator service, heat, light and water which required regular and continuous activity and the employment of labor, the buying of material and many other things which come within the definition of business." More recently, in *Fahs v.*

Crawford (C. C. A. 5), 161 F. 2d 315, 318, the court, sustaining the taxpayer, pointed out:

“Carrying on a business, however, implies an occupational undertaking to which one habitually devotes time, attention and effort with substantial regularity.”

The conclusion must follow that petitioner’s passive receipt of minimum royalties did not in itself constitute a trade or business.

(5) These patents were not used in petitioner’s trade or business merely because they may have originated in his trade or business.

The Tax Court in its opinion answers point (4) above as follows:

“Nor do we consider it realistic to look only at the receipt of royalties divorced from the efforts and accomplishments leading up to such receipt and to say such passive receipt does not constitute a business.”

[R. 48.]

Here the Tax Court is confusing the origin of a thing with its use. The act or process of creating something or bringing something into being is one thing; the act or process of using it or carrying it on is something wholly different. *McDonald v. Commissioner*, 323 U. S. 57. In that case the Supreme Court sustained the denial of a deduction for expenses incurred in campaigning for office, pointing out that such expenses represent the cost of getting the office, not of carrying it on.

Even if one assumes then that the patents here originated in petitioner’s business—which petitioners do not

concede—they were not for that reason used in his business.

(6) Petitioner's flat band patents were therefore mere investments and not property "used in the trade or business."

It has been shown that the receipt of the royalties on the flat band patents was not in itself a trade or business, and that the patents were not property used in a trade or business merely because they may have originated in a trade or business. Nor is there any other basis suggested by the record upon which a contention of such use can be predicated. Certainly at the time of their sale in 1938 these patents were mere investments.

The fact that they were sold to obtain capital for expansion emphasizes this fact. One does not normally sell an asset *used* in the business in order to raise capital for *expanding* the business. Indeed, the purpose of the sale is the very purpose for which the capital gain provisions were enacted. As above observed, those provisions were enacted because it was found that "an excessive tax on capital gains freezes transactions and prevents the free flow of capital into productive investments." Report—Senate Finance Committee, 75th Cong. 3d Sess. S. Rept. 1567, page 6; 1939-1 C. B. Part 2, p. 783. Whatever may have been the origin of the patents here involved, at the time of the sale they were mere investments and not property used in a trade or business.

Certainly, considering all of the circumstances here and the limited construction to be given the statutory provision, as outlined in point I above and part (a) of this point III, the conclusion is warranted that the flat band patents were not property used in the trade or business.

Issue No. 2: Whether Certain Portions of the Sales Price Paid by Petitioners to Others Can Properly Be Excluded From or Offset Against the Selling Price, and Whether in That Connection the Tax Court Should Have Granted Petitioners' Motion for Rehearing.

I.

For This Purpose the Payments Must Be Classified as Capital Expenditures, So That It Is Unnecessary to Show That They Were Ordinary and Necessary and Reasonable but Only That They Were Bona Fide and Actually Incurred in Connection With the Transaction.

The application of an expense incurred in connection with a sale as an *exclusion* from or *offset* against the selling price is not dependent upon its being "ordinary and necessary," and "reasonable," as required in the case of a *deduction* under Section 23(a) of the Internal Revenue Code for compensation paid for personal services. Such application of an expense as an exclusion or offset is not made under Section 23(a), but under Section 22(a) in arriving at the gross income from the transaction. In *Victoria Paper Mills Co. v. Com.*, 32 B. T. A. 667, affirmed *per curiam*, C. C. A. 2, 83 F. 2d 1022, the Board stated:

"The rule is well settled that commissions and other similar charges, including attorney fees, incident to the sale of or other disposition of property ordinarily are to be treated as *capital* expenditures and are de-

ductible from the selling price in determining the amount of the gain or loss on the transaction.” (Italics supplied.)

The Internal Revenue Code contains no specific requirements in regard to capital expenditures. It provides only, in so far as here pertinent, as follows:

a. In Section 111(a), that the “gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113(b) for determining gain,” and

b. In Section 113(b), that in determining such adjusted basis proper adjustment in respect of the property shall “in all cases” be made for “expenditures, receipts, losses, or other items, properly chargeable to capital account, . . .”

It is fair to conclude that with respect to the payments to Lawrence and Herbert it is sufficient to show that the payments are *bona fide* and that they were actually incurred in connection with the sale of the patents.

II.

The Payments to Lawrence Were Bona Fide and Actually Incurred in Connection With the Sale of the Patents, and Should Therefore Be Allowed as Capital Expenditures.

Petitioner engaged his son, Lawrence, to negotiate a sale of the patents to Gerrard, agreeing in advance to compensate him if he succeeded. He did succeed. The necessary implication is that he succeeded in making a deal satisfactory to petitioner. The amount of the sale was large, \$425,000. The notes received as a part of the sales price were worth face value when received.

Lawrence, indeed, was only 28 years of age at the time. But that is an extremely weak objection. Many of the greatest accomplishments in history were those of men under that age. Alexander the Great died at 32, having conquered much of Europe and most of Asia. Keats died when he was 26, having become one of the greatest poets of all time. Einstein first announced his theory of relativity in 1905, when he was only 26. Hutchins became president of the University of Chicago when he was 29. Any biographical dictionary will reveal hundreds of such names. Lawrence's youth cannot be used as a point here.

Lawrence's task was certainly not a simple one. His only instruction was to make a deal. Although he was an attorney, his task was as negotiator. In other words, it was his job to negotiate the sale, at a price and on terms satisfactory to petitioner. When petitioner agreed to pay him 20 per cent of the proceeds of the sale as his compensation petitioner knew, not only that there would be no tax saving, but that on the contrary there would be a tax loss instead. The *bona fides* of the payments cannot be

questioned; and clearly they were incurred in connection with the sale. They should therefore be allowed as capital expenditures in arriving at the gain on the sale.

III.

The Payments to Herbert Were Payments for His Interest in the Patents.

Herbert had assisted petitioner in developing the patents, advising and discussing in reference to them evenings, Sundays and holidays. Petitioner paid him 10 per cent of the annual minimum royalty received from Gerrard. When the patents were sold he settled with Herbert by agreeing to pay him \$2,500 out of each payment of \$40,000 received from Gerrard. In the contract of sale petitioner expressly agreed to transfer not only his own interest in the patents but any interest Herbert might have.

Petitioner and Herbert were brothers. It is not unusual for brothers working together as long as these did to have understandings which are not put into so many express words but which are nevertheless recognized between them and carried out in their actual conduct. The payment to Herbert of 10 per cent of the royalties, each and every month, from the very inception in 1930 and right up to the sale in 1938 cannot otherwise reasonably be regarded. The undertaking in the contract of sale to transfer Herbert's interest as well as his own but reinforces that conclusion. The Tax Court made no finding of fact that Herbert had no interest in the patents; but if it had, such finding would be in clear conflict with the evidence. The payments to Herbert of \$2,500 out of each \$40,000 received on the sale of the patents should be excluded or deducted therefrom as payment to Herbert for his interest in the patents.

IV.

In Any Event, the Payments to Herbert Were Capital Expenditures Incurred by Petitioner in Connection With the Patents and Therefore Deductible as Offsets Against the Selling Price.

Assuming that Herbert had no interest in the patents, the question remains whether the amounts paid him were *bona fide* payments in connection with the patents and therefore capital expenditures deductible in any event as offsets against the selling price. The Tax Court concedes in its opinion that Herbert assisted petitioner in his work on the inventions and that his advice was “invaluable” to petitioner. [R. 49.] According to Webster’s Unabridged Dictionary, “invaluable” means “valuable beyond estimation, inestimable, priceless, precious.” It must follow that petitioner’s payment to Herbert of only \$2,500 out of each \$40,000 received by him on the sale of the patents was a gross underpayment. It must follow also that the Tax Court’s refusal to exclude that amount in arriving at the gain to petitioner was arbitrary and a gross miscarriage of justice.

Even if the tests of “ordinary and necessary” and “reasonable” were applied, as they would be if the payments were for services rendered in the carrying on of a trade or business, even then the payments would merit allowance. It would be immaterial, of course, that Herbert’s services were rendered in prior years. (*Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115.) It would be immaterial also whether petitioner was obligated to make the payments to Herbert. [*Ibid.*] It would only be necessary to show that the services were worth the payments made; and the Tax Court has amply conceded that. *A fortiori* here, where the tests of “ordinary and necessary” and

“reasonable” are not applicable, where the question is solely one of *bona fides*, the payments being claimed as capital expenditures, their deduction should be allowed.

V.

The Tax Court, Having Found That Services Were Rendered by Lawrence and Herbert, Was at Least Under a Duty to Make a Determination and Finding as to Their Value and to Allow Such Amount as Deductions; and to That End, If Necessary, the Court Should Have Granted Petitioners’ Motion for Rehearing.

It is clear since *Helvering v. Taylor*, 293 U. S. 507, that the Tax Court bears an administrative burden. The Tax Court cannot relieve itself of the burden of determining a value, or a reasonable amount, wherever such factors are in issue, merely because the taxpayer’s evidence was inadequate. The *Taylor* case involved a valuation of property. In *George M. Cohan v. Commissioner* (C. C. A. 2), 39 F. 2d 540, the same principle was applied in determining an amount allowable as “ordinary and necessary” expenses. More recently, in *W. D. Haden Co. v. Commissioner* (C. C. A. 5), 165 F. 2d 588, the Court stated:

“It is also clear that if the sales contracts drew no interest they ought to be discounted according to the prevailing rates of interest to find their then value. That is a matter of law. But we do not think that because an appraisement was not made in 1932, or because neither side asked the witness as to value to figure out this discount, the court is excused from doing it. Law and justice require either that the Tax

Court should figure it out for itself, or having announced that this must be done to arrive at a proper value, should reopen the hearing that the taxpayer may supply the omission. As to this item we set aside the disallowance and direct that the hearing be reopened for further evidence.”

Here the Tax Court, in reference to the payments to Lawrence, found as a fact that he had “assisted petitioner in negotiating the sales contract with Gerrard.” Clearly then the Commissioner was in error in allowing no deduction at all in respect of the payments to Lawrence. Yet the Tax Court, observing that Lawrence did not testify at the hearing, and that it had “only petitioner’s very vague recitations as to his son’s services,” simply sustained the Commissioner’s determination. We contend that petitioner’s evidence in this respect was not vague but clear and full. Be that as it may, however, the Tax Court was under a duty to make a determination of value.

The same is true in regard to the payments to Herbert. With respect to both Lawrence and Herbert the petitioners sought a rehearing for the purpose of taking their testimony, and in that connection filed affidavits showing what such testimony would contain. In the light of the *Haden Co.* case, *supra*, since the Tax Court had failed to make a determination of value of the services of Lawrence and Herbert, its failure to grant the rehearing was improper.

Issue No. 3: Whether the Tax Court Should Have Granted Petitioners' Motion for Judgment on the Pleadings.

I.

Except for Treatment of the Sale of Patents to Gerard in 1938 as a "Casual" Sale Under Section 44(b) of the Revenue Act of 1938 There Is No Basis for Including in Petitioners' Gross Income in Any of the Taxable Years Here Involved Any Part of the Proceeds of the Said Sale.

The sale of patents took place in 1938. The total consideration was \$425,000. Of said total \$25,000 was payable and paid upon execution of the sale; and the balance of \$400,000 was payable and paid at the same time by delivery to petitioner of 10 negotiable promissory notes in his favor in the sum of \$40,000 each, jointly made by Gerard and its parent company, the American Steel and Wire Company of New Jersey. In filing their return for 1938 petitioners elected to return the gain on said sale on the installment basis under Section 44(b) of the Revenue Act of 1938 [App. p. 1], but otherwise filed their returns for the year 1938 on the accrual basis. All this was alleged by petitioners in their petitions and admitted by the Commissioner in his answers.

The years involved here do not include 1938, but only the years 1939, 1940 and 1941. Under the accrual method, which the petitioners used except for the election made by them under Section 44(b) of the Revenue Act of 1938 with respect to the sale of patents, the notes were necessar-

ily includible in gross income in 1938. (*U. S. v. Anderson*, 269 U. S. 422; *Continental Tie and Lumber Co. v. U. S.*, 286 U. S. 290.) This would be true even if the notes became bad in whole or in part before the year of sale was over. Relief then could be had only through a deduction for bad debts. (*Spring City Foundry Co. v. Commissioner*, 292 U. S. 184.) Even on a cash basis, except for the installment election, those notes were includible in gross income in 1938. (*Wolfson v. Reinecke* (C. C. A. 7), 72 F. 2d 59; *Cherokee Motor Coach Co., Inc., v. Com.* (C. C. A. 6), 135 F. 2d 840.)

Section 44(a) of the Revenue Act of 1938, quoted in the Appendix, page 1, is inapplicable, since by its terms it applies only to a dealer who regularly sells on the installment plan, and with respect to the entire installment business; it cannot apply to a single transaction. (G. C. M. 1162, VI-1 C. B. 22.) Except for Section 44(b), which in respect to personal property applies only to a "casual" sale, there is no basis in the revenue law for including in petitioners' gross income in any year after 1938 any portion of the total consideration of \$425,000, or any amounts with respect to the payments received on the notes of \$40,000 each which were part of that consideration.

II.

The Portion of Section 117(a)(1) of the Internal Revenue Code Under Which Are Excepted From Capital Assets Classification,

1. "Stock in Trade of the Taxpayer"
2. "Other Property of a Kind Which Would Properly Be Included in the Inventory of the Taxpayer if on Hand at the Close of the Taxable Year," and
3. "Property Held by the Taxpayer Primarily for Sale to Customers in the Ordinary Course of His Trade or Business,"

Cannot Apply to a Sale Returnable as a "Casual" Sale Under Section 44(b) of the Revenue Act of 1938.

Section 44(b) of the Revenue Act of 1938 is quoted in the Appendix, page 1. In 1939 it became, without change, Section 44(b) of the Internal Revenue Code. Under that subsection a disposition of personal property for a price exceeding \$1,000 is returnable, at the taxpayer's election, on the installment plan if it is a "casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year)."

The parenthetical portion of the provision was adopted in 1928 and was merely declaratory of existing law. The House and Senate committees reported that insertion in the law as follows:

"The committee regards as properly interpretative of existing law the departmental ruling that the sale of an item of the taxpayer's inventory should under

no circumstance be regarded as a casual sale.” (1939-1 C. B. Part 2, pp. 394, 425.)

The subject resulted in the following interchange on the floor of the House:

“Mr. Hastings: Will the gentleman tell me what is meant by the language ‘casual sale or other disposition of personal property’?”

Mr. Green of Iowa: That is a single sale that is not in the regular business.

Mr. Hastings: Is that in the existing law?

Mr. Green of Iowa: Yes; that is the same as in the existing law. It has been that way for a long while and we have never had any trouble with the provision.” (69 Cong. Rec. 513-514.)

It is clear, of course, from the parenthetical portion of the provision quoted from Section 44(b) that a sale of property of a kind includible in the taxpayer’s inventory cannot come within that provision. It is clear also that if petitioner’s sale of patents was a sale of “stock in trade” of his, or of property held by him “primarily for sale to customers in the ordinary course of his trade or business” it was not a “casual” sale. (G.C.M. 1162, VI-1 C. B. 22; *50 East 75th Street Corporation* (C. C. A. 2), 78 F. 2d 158; *E. M. Funsten v. Commissioner*, 44 B. T.A. 1166.) In the *Funsten* case, involving a sale of securities, the Board stated, at page 1169:

“In the *McCutcheon* case the sale was by a security company and manifestly occurred in the regular course of business. It did not fall within subsection (b) because it was not a casual sale”

It must follow that the portion of Section 117(a)(1) of the Internal Revenue Code under which are excepted from

capital asset classification "stock in trade of the taxpayer," "other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year," and "property held primarily for sale to customers in the ordinary course of his trade or business," cannot apply to a sale returnable as a "casual" sale under Section 44(b) of the Revenue Act of 1938.

III.

Since the Commissioner in His Answer Took a Position Inconsistent With the Treatment of the Sale of Patents to Gerrard as a "Casual" Sale, the Petitioners' Motion for Judgment on the Pleadings Should Have Been Granted.

(a) A motion for judgment on the pleadings should be granted where the position taken by the opposite party on the facts, if it represented the truth, would require such a judgment, and such opposite party fails to amend.

A motion for judgment on the pleadings is in the nature of a demurrer. It is in substance both a motion and a demurrer: a demurrer for the reason that it attacks the sufficiency of the pleadings, and a motion for the reason that it is an application for an order for judgment. On a motion for judgment on the pleadings every allegation affirmatively set up in the answer must be deemed true, and every allegation of the party moving which has been controverted must be deemed untrue. (*Osborne v. Abels*, 30 Cal. App. 2d 729, 730-731, 87 P. 2d 404. To same effect, *N. Y. Life Insurance Co. v. Bidoggia et al.* (Dist. Ct. Idaho), 17 F. 2d 112; *Compagnia Italiana Transporto Olii Minerali v. Sun Oil Co.* (Dist. Ct. N. Y.), 29 F. 2d 744; *Smith v. Beauchamp*, 71 Cal. App. 2d 250, 256, 162 P. 2d 662.) This point with respect to any allegation ex-

tends to all fair inferences to be drawn from the allegation. (*Frank Gilbert Paper Co. v. Prankard*, 204 App. Div. 83, 198 N. Y. S. 25, aff'd. 195 N. Y. S. 638.) And where, after motion for judgment on the pleadings has been made and the defects in opposing party's pleadings pointed out, he fails to ask leave to amend, it will be assumed that his pleading states the case as favorably to him as possible. (*Gross v. Bank of America, Nat. T. & S. Assn.*, 4 Cal. App. 2d 353, 355, 41 P. 2d 178.)

(b) The Commissioner in his answer took a position on the facts which, assuming it to represent the truth, would require judgment for petitioners, and the Commissioner failed to amend.

The Commissioner in his answer denied petitioners' allegations that the patents sold were not stock in trade of petitioner, or other property of a kind which would properly be included in his inventory if on hand at the close of the taxable year, or property held by him primarily for sale to customers in the ordinary course of his trade or business. The Commissioner thus took the position that the patents were such property. From the analysis under points I and II above it follows that in his answer he took a position inconsistent with treatment of the sale as a "casual" sale, and therefore inconsistent with the inclusion in gross income, for the taxable years here involved, of any part of the proceeds of the sale.

All that petitioners asked for in their petition was exclusion from the proceeds of the said sale of the portion paid Lawrence and Herbert, and treatment of the balance as capital gain. At no time have they asked for more. Therefore, if a position of the Commissioner inconsistent with inclusion in gross income of *any part* of the proceeds

of the sale represented the true state of the facts, there would be nothing left to try, and a judgment for petitioners would be required.

The Commissioner took such a position in his answer. After petitioners by motion for judgment on the pleadings point out the defect, he made no attempt to amend. On the contrary, at the opening of the hearing he expressly stated that it would be his contention, *inter alia*, that the patents were property held by petitioner "primarily for sale in the ordinary course of the trade or business." It follows that the motion for judgment on the pleadings should have been granted.

Conclusion.

Petitioners submit that the gain resulting from the sale of the flat band patents to Gerrard in 1938 should be treated as capital gain; that the amounts paid out of the proceeds of said sale to Lawrence A. Harvey and Herbert Harvey should be allowed as offsets against the selling price; and that petitioners' motion before the Tax Court for judgment on the pleadings should have been granted.

If this Court believes that additional findings of the Tax Court may be necessary in any respect, petitioners request that the cause be remanded for that purpose.

Respectfully submitted,

GEORGE T. ALTMAN,

Attorney for Petitioners.

October 1, 1948.

APPENDIX.

Statutes.

Revenue Act of 1938:

"SEC. 44. INSTALLMENT BASIS.

"(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

"(b) *Sales of Realty and Casual Sales of Personality.*—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price . . . , the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section"

* * *

Internal Revenue Code:

"SEC. 22. GROSS INCOME.

"(a) *General Definition.*—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service . . . , of whatever

kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; . . .”

* * *

“SEC. 23. DEDUCTIONS FROM GROSS INCOME.

“In computing net income there shall be allowed as deductions:

“(a) *Expenses.*—

“(1) *Trade or Business Expenses.*—

“(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; . . .”

* * *

“(2) *Non-Trade or Non-Business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.”

* * *

“SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

“(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, . . .”

* * *

“SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.”

* * *

“(b) *Adjusted Basis*.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

“(1) *General Rule*.—Proper adjustment in respect of the property shall in all cases be made—

“(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, . . .”

“SEC. 117. CAPITAL GAINS AND LOSSES.

“(a) *Definitions*.—As used in this chapter—

“(1) *Capital Assets*.—The term ‘capital assets’ means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1); . . .”

* * *

Regulations.

Regulations 111:

“Sec. 29.22(c)—1. Need of inventories.—In order to reflect the net income correctly, inventories at the beginning and end of each taxable year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. The inventory should include all finished or partly finished goods and, in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, . . .”

No. 11,823

**In the United States Court of Appeals
for the Ninth Circuit**

LEO M. HARVEY AND LENA P. HARVEY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE RESPONDENT

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FILED

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PAUL P. O'BRIEN,

CLERK

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*ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX
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BRIEF FOR THE RESPONDENT

OPINION BELOW

The finds of fact and opinion of the Tax Court (R. 42-50) are not officially reported.

JURISDICTION

This petition for review (R. 59-65) involves federal income taxes for the taxable years 1939, 1940 and 1941. On November 17, 1944, the Commissioner of Internal Revenue mailed to each of the taxpayers a notice of deficiency in the total amount of \$15,651.84. (R. 19.)¹ Within ninety days thereafter, and on February 12, 1945, the taxpayers filed the petitions with the Tax Court for redetermination of those deficiencies under

¹ The pleadings in the Lena P. Harvey case were omitted from the record. (R. 125.)

the provisions of Section 272 of the Internal Revenue Code. (R. 10-29.) The decisions of the Tax Court sustaining the deficiencies were entered July 17, 1947. (R. 57-59.) The case was brought to this Court by a petition for review filed October 17, 1947 (R. 59-65), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTIONS PRESENTED

(1) Did the Tax Court err in determining that the sale of the patents here involved was not a sale of capital assets under Section 117 (a) (1) of the Internal Revenue Code and was therefore productive of ordinary income?

(2) Did the Tax Court properly determine that taxpayer had failed to prove that his son had rendered any valuable services in connection with the sale so as to justify the exclusion from the sales price of the sum of \$85,000 paid by taxpayer to his son for services allegedly rendered?

(3) Did the Tax Court properly determine that there was no evidence to indicate that taxpayer's brother had any property interest in the patents?

(4) Did the Tax Court err in denying taxpayer's motion for a judgment on the pleadings?

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved may be found in the Appendix, *infra*.

STATEMENT

The formal findings of fact of the Tax Court (R. 43-46) are set out as follows:

Taxpayers are husband and wife residing in Los Angeles. Unless otherwise indicated "taxpayer" will

hereinafter refer to the husband, Leo M. Harvey. (R. 43.)

By written agreement dated March 21, 1938, taxpayer sold certain patents and applications for patents, both foreign and domestic, to the Gerrard Company, Inc., hereinafter referred to as Gerrard. The patents so sold by taxpayer covered inventions in the round wire tying and the flat band strapping and tying fields. As here material, Gerrard paid as consideration \$25,000 cash upon execution of the agreement and delivered to taxpayer ten negotiable promissory notes, each in the amount and each having then a fair market value of \$40,000, all dated April 2, 1938, numbered one to ten, inclusive, and maturing serially commencing April 2, 1939, and thereafter on April 2 of each succeeding year through April 2, 1948. These notes were tendered and accepted as payment. During the taxable years here involved these notes were paid when due. (R. 43.)

By written agreement and under circumstances hereinafter described taxpayer paid his son Lawrence twenty per cent of the proceeds of the sale as received by taxpayer. Taxpayer also paid certain amounts to his brother Herbert from such proceeds. Herbert was thus paid \$2,500 in each of the taxable years here involved. (R. 43-44.)

In reporting the proceeds of the sale for income tax purposes taxpayers excluded or deducted from the sales price certain amounts on account of such obligations or payments to Lawrence and Herbert. The remainder of the sales price was reported on the installment basis and treated as capital gain, each taxpayer reporting a community one-half. Thus, taxpayers reported as taxable gain to be taken into account from the sale the amount of \$15,828.72 for each of the taxable years here involved, each taxpayer reporting a

community half thereof, or \$7,914.37.² The Commissioner determined that the entire proceeds received constituted ordinary income to taxpayers and not capital gain. The Commissioner in this connection stated (R. 44):

It is determined that the entire \$40,000.00 received in each year is taxable as ordinary income. Your community share of this income has accordingly been increased in each year by the amount of \$2,085.63 from the \$7,914.37 (total reported as above) to \$20,000.00.

Taxpayer's son, Lawrence, was an attorney about twenty-eight years old in 1938. He assisted taxpayer in negotiating the sales contract with Gerrard. Taxpayer agreed in writing dated April 2, 1938, to compensate Lawrence for his efforts in this connection by paying twenty per cent of all proceeds of the sale as received by taxpayer. Under this agreement taxpayer paid Lawrence \$8,000 a year during the taxable years. Taxpayer also employed as attorneys in connection with the Gerrard deal, Max Schlesinger, who handled the tax aspects, one Rubin and a Walter Sheldon. Walter Sheldon was paid \$22,500 in 1938 by taxpayer for his services, which services among others included Sheldon's work in connection with the Gerrard sale. (R. 45.)

Taxpayer's brother, Herbert, had been an employee of taxpayer since about 1918 on a salary ranging from \$500 to \$1,500 a month. Taxpayer, since about 1914, had been sole proprietor of a business known as Harvey Machine Company. This business consisted primarily of making industrial machinery on special order. Herbert was employed in connection with this business. (R. 45.)

² The figure of \$7,914.37 was the one actually reported rather than \$7,914.36.

Taxpayer with the advice and assistance of Herbert had commenced developing inventions in the wire tying field in the middle 1920's and subsequent thereto and from time to time obtained the patents sold to Gerrard. The expenses of developing these inventions were deducted as business expenses of Harvey Machine Company. Some time in 1930 taxpayer licensed Gerrard to operate under certain of the flat wire tying patents at a minimum royalty of \$30,000 a year, which taxpayer received from 1931 to 1937, inclusive. In 1938 and by the terms of the sales contract Gerrard agreed to pay taxpayer certain amounts on account of royalties due up to and including March 31, 1938. These royalty payments were reported by taxpayer as income from the business of Harvey Machine Company. Taxpayer had paid Herbert ten per cent of the \$30,000 annual minimum royalty received by taxpayer from Gerrard. The sales contract with Gerrard stated that it was understood between the parties that the patents involved and referred to as owned by taxpayer included not only those owned by taxpayer but "also patents, patent applications and inventions, if any, owned by Herbert Harvey * * *." (R. 45-46.)

The Tax Court found further in its opinion (R. 46-50) that the patents were used in taxpayer's business, as an inventor, and were subject to depreciation; that taxpayer had failed to sustain the burden of proving that his son had rendered any valuable services in connection with the sale; and that taxpayer had failed to sustain the burden of proving that his brother had any property interest in the patents, or that payments to his brother were deductible or excludible from the sale price.

SUMMARY OF ARGUMENT

The patents sold clearly constituted property used in the trade or business of a character subject to depreciation, and as such were excluded from the definition of "capital assets" under Section 117 (a) (1) of the Internal Revenue Code. The evidence amply supports the Tax Court's determination that taxpayer was engaged in the business of developing and patenting inventions. It is indisputable that the patents were subject to depreciation. Where in the course of business a taxpayer devotes property to rental purposes and to the production of taxable income, the property is used in the trade or business. Whether or not the patents were used in the trade or business of taxpayer was a question of fact, and since the Tax Court's determination was not clearly erroneous it should be upheld. From the record it is manifest that the Tax Court correctly held that taxpayer had failed to sustain his burden of proving that his son had rendered any valuable services in connection with the sale. This being so, taxpayer was not entitled to an exclusion from the sale price for any sum paid his son, far less the sum of \$85,000. There is no evidence in the record to indicate that taxpayer's brother had any property interest in the patents or rendered any services in connection with the sale so as to justify an exclusion in any amount from the sale price. Taxpayer's brother had been adequately compensated for all services rendered during prior years in the development of the patents, and these services were rendered by him as an employee. Taxpayer's contention that judgment on the pleadings should have been rendered is completely lacking in merit since the real issues in the case were primarily disputed issues of fact.

ARGUMENT

I

The Tax Court properly held that the patents sold were not capital assets under Section 117 (a) (1) of the Internal Revenue Code

Section 117 (a) (1), Appendix, *infra*, excludes from the term "capital assets" any property which is "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23 (1)." The conclusion seems unavoidable that the flat band patents sold here were utilized for the production of income in taxpayer's business, and were thus not capital assets.

Taxpayer's testimony as to the number of years involved in the development of the flat band patents was ambiguous. His testimony indicates that he first gave thought to the problem of developing a wire tying device around 1924 or 1925 (R. 86), and that the earliest patent for a flat band wire tying machine was obtained on July 17, 1928 (R. 101). At the time of the sale, a large number of flat band patents had been obtained by taxpayer. (R. 73.) The first rights to operate under these patents were assigned to the Tying Machines Company for an undisclosed consideration. (R. 101.) Subsequently, the Gerrard Company bought out the Tying Machines Company, and a royalty agreement was consummated whereby the Gerrard Company paid to the taxpayer a yearly \$15,000 royalty on the foreign flat band patents and a similar royalty on the domestic flat band patents; and these payments were continued until the time of the sale. The general rule has often been reiterated that where the owner of depreciable property devotes it to rental purposes and

to the production of taxable income, the property is used by him in a trade or business. *Vosburgh v. Commissioner*, 23 B. T. A. 780; *Kimbell v. Commissioner*, 41 B. T. A. 940; *Fackler v. Commissioner*, 45 B. T. A. 708, affirmed, 133 F. 2d 509 (C.C.A. 6th). As early as 1911, the Supreme Court held that a corporation which owned and leased taxicabs and collected the rents therefrom was "carrying on or doing business" within the meaning of the Corporation Excise Tax Act of 1909, c. 6, 36 Stat. 11, 112, Sec. 38. *Flint v. Stone Tracy Co.*, 220 U. S. 107.

Taxpayer contends, however, that the mere passive receipt of rentals cannot be considered as operating business; and further that the patent activities were not connected with his business, which was the manufacture of machines on special order. Apparently taxpayer would ignore the years of effort and the funds consumed in the development of the patents which ultimately brought a yearly royalty of \$30,000, and a sales price of \$425,000. Apart from the time spent on the development of the original flat band patents, under the agreement with Gerrard, taxpayer agreed to complete certain work in connection with pending applications. (R. 83.) Indeed, the very first models made under the flat band patents for the Gerrard Company were made by taxpayer. (R. 82.) Thus, even if it were true that taxpayer's only business was the manufacture of machines on special order, it would be clear that the flat band patents were used in taxpayer's trade or business.

The record is, however, replete with evidence which supports the finding of the Tax Court that taxpayer was engaged not only in the business of manufacturing but also in the business of developing and patenting inventions for the production of income. In addition to the flat band patents, taxpayer developed and secured pat-

ents on round wire tying devices, a paper dispenser, a part of a washing machine, and a device for cutting oranges. (R. 88, 92, 93.) Taxpayer testified that "maybe there were more." (R. 93.) Taxpayer admitted that there were a large number of other devices to which he devoted some time and which did not result in the procurement of a patent. (R. 94.) He further testified that when he began developing these ideas, it was the practice to construct models and make drawings. (R. 88.) Again, taxpayer's testimony was not clear as to the period of time devoted to his inventive activities, but the record as a whole supports the inference that it was considerable. Taxpayer testified, for example, that he first began work on round wire tying devices in 1927 and that he was still working on them as late as 1935. (R. 99.) At least on one return, taxpayer stated his occupation to be proprietor of a machine shop and inventor. (R. 112.) The royalty income obtained from the patents here involved was included in the business income on taxpayer's returns. (R. 112-115.) The expenses incurred by taxpayer in connection with his development of the several patents were deducted as business expenses. (R. 94-95.)

Moreover, the reasons suggested by the taxpayer for his development of patents indicate that they were developed for use in taxpayer's business. He testified that patents were developed so that they would "help us in making the article, nobody else will encroach on * * *." (R. 90.) Taxpayer testified further that in developing patents he considered the possibility of obtaining royalties from them. (R. 91.) Whether taxpayer developed patents so that he might thereby obtain an exclusive right to manufacture the devices himself, or whether he developed them for the production of royalty income, the patents were used for the production of income in taxpayer's trade or business. Nor

were the flat band patents the only patents disposed of for a consideration. The right to utilize taxpayer's round wire patents had been assigned to the Gerrard Company for a consideration which taxpayer could not recall; and all the round wire tying devices were sold in 1938. (R. 100.) The patents pertaining to washing machines were also transferred to another corporation for a consideration which taxpayer could not recall. (R. 102-103.)

Although it is true that taxpayer testified that he developed inventions because he enjoyed doing so, it is manifest that the enjoyment of pleasure or recreation from an undertaking cannot change its character from a business to a hobby. Whether taxpayer's inventive activities were carried on as a business or as a hobby was a question of fact to be determined by the Tax Court, as was the question of whether the patents here involved were utilized in taxpayer's trade or business. *Greene v. Commissioner*, 141 F. 2d 645 (C. C. A. 5th) certiorari denied, 323 U. S. 717. Since the scope of review over decisions of the Tax Court is now the same as that exercised over judgments of the District Courts in non-jury cases, the findings of the Tax Court may not be reversed unless clearly erroneous. Section 36, Public Law 773, 80th Con., 2d Sess., approved June 25, 1948. The evidence here amply supports the Tax Court's determination that the patents sold were utilized for the production of income in taxpayer's trade, as an inventor. Since it is indisputable that the patents were subject to depreciation under Section 23 (1) and Treasury Regulations 103, Sec. 19.23(1)-7, Appendix, *infra*, the patents were excluded from the term "capital assets" under Section 117 (a) (1), and the sale of the patents was productive of ordinary income.

In *Fackler v. Commissioner*, *supra*, the Board of Tax Appeals held that a leasehold was property used in a

trade or business within the meaning of Section 117 (a) (1), where taxpayer devoted all his business hours to his profession, as an attorney, and only one or two hours a month to the leasehold premises. The decision was upheld by the appellate court, which pointed out that whether property is used in a trade or business is an ultimate fact for the trial court, whose finding will be sustained if supported by the evidence. In the instant case, there is far more evidence than in the *Fackler* case from which the Tax Court could have concluded that taxpayer's activities in developing and patenting devices for the production of income constituted the carrying on of a business.

The facts in the instant case are strikingly similar to those in *Smythe v. Commissioner*, decided June 25, 1942 (1942 P-H B. T. A. Memorandum Decisions, par. 42,377), in which the Board of Tax Appeals stated:

Assuming this, we think it follows that the subject matter of the sale both was depreciable property used by petitioner in his trade or business, and that it had been held for sale to customers in the regular course of that business. For petitioner gives his occupation as that of an inventor. He deducts and has been allowed, as business expense, payments made in connection with that occupation. We cannot say that this is not a "trade or business," nor, if it is, that the fruits of inventive genius are other than the stock in trade of that business. Their conversion into gain or profit measured in monetary terms would most typically take the form of a sale or license of the idea resulting and of the exclusive privilege to the use of that idea conferred by the protection of the patent law. Here petitioner resorted to both types of the realization of gain. He issued a license calling for the payment to him of a stipulated fee and ultimately made his invention the subject of a sale. These circumstances satisfy us that under the facts as they presently appear the subject matter of the sale was not

a capital asset as that term is defined. *John D. Fackler*, 45 BTA 708, 714. Of course, the business in which petitioner was engaged is the very essence of this reasoning.

Taxpayer's entire argument on this issue is directed toward an attempt to prove that the flat band patents were not used in taxpayer's machine business. This approach indicates a misconception as to the purport of the Tax Court's decision. The Tax Court held that taxpayer was engaged also in the business of developing patents, and that these patents were utilized for the production of income in his business as an inventor.

Taxpayer (Br. 22) relies on the case of *Albright v. United States*, 76 F. Supp. 532 (Minn.), for the proposition that the phrase "used in the trade or business" means "used by the taxpayer in his trade or business at the time of the sale." Taxpayer's conclusion is that at least at the time of the sale, the patents were not used in his trade or business. The *Albright* case not only fails to support the taxpayer but demonstrates the weakness of his position. In the first place, in the *Albright* case, there was evidence of an actual physical conversion at or prior to the time of sale. In the instant case, the taxpayer held his patents for the production of royalty income in his business as an inventor up until the very time of sale. Depreciable business property retains its character as such even if not in use in the business at the time of sale unless it has been converted to another purpose prior thereto. *Carter-Colton Cigar Co. v. Commissioner*, 9 T. C. 219; *Kittredge v. Commissioner*, 88 F. 2d 632 (C. C. A. 2d); *Wright v. Commissioner*, 9 T. C. 173; *Yellow Cab Co. of Pittsburgh v. Driscoll*, 24 F. Supp. 993 (W. D. Pa.).

Furthermore, even if the doctrine of the *Albright* case were here applicable, it would avail the taxpayer little; for under the rationale of the *Albright* case, the

patents here involved, if not “property, used in the trade or business” at the time of the sale, would be considered as “property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business”, and would for that reason be excluded from the definition of “capital assets” under Section 117 (a) (1). The *Albright* case arose under Section 117 (j) of the Internal Revenue Code which provided that a taxpayer might treat the sale of depreciable property used in the trade or business as the sale of a capital asset. This section was, of course, not in the revenue law during the calendar years here involved. In the *Albright* case it was therefore essential to determine whether certain livestock were “used in the trade or business,” in which case they could be treated as capital assets, or whether they were held “primarily for sale to customers in the ordinary course of his trade or business,” in which case their sale would produce ordinary income. The Government’s position, which was sustained, was that the breeder of livestock who regularly sells a portion of his herd each year, has a dual motive in raising each head of livestock, use as a breeder and ultimately sale; and that at the time of the sale, the livestock were held primarily for sale. Applying the *Albright* doctrine here, we find that taxpayer developed patents for use in his business, but for ultimate disposition by sale; and in fact, that three of the five basic patents mentioned in the record were ultimately sold. It might therefore be contended that at the time of the sale, the patents were “held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business” and excludible from the definition of “capital assets” for that reason.

Indeed, this alternative contention was made in the Tax Court. Since there is ample evidence to support the Tax Court’s finding that the patents were used in

the taxpayer's trade or business, it is not essential that we determine whether or not the patents fall within another exclusion. It can, however, be persuasively argued, in the alternative, that the patents were held "primarily for sale to customers in the ordinary course of his trade or business." There is little doubt that taxpayer had in mind the sale of some of these patents if an attractive proposition were made. Apart from the sale of the flat band patents, taxpayer did dispose of the round wire tying patents and the washing machine patents for undisclosed consideration. Undoubtedly he would have sold the other devices if a suitable opportunity arose. See *Goldsmith v. Commissioner*, 143 F.2d 466 (C. C. A. 2d), certiorari denied, 323 U. S. 774.

The language utilized by the Board of Tax Appeals in *Avery v. Commissioner*, 47 B. T. A. 538, is particularly applicable (p. 542):

The primary use to petitioner of the appliances and devices developed by his creative genius and the patents issued thereon was the gain to be derived from the sale or other disposition of the patents to persons or corporations to whom they were of beneficial use. What may have been a hobby originally became a trade or business when he held the patents for sale or license to others for profit. We think it is immaterial that he created no new devices or received no new patents in the year he sold the patent to the Marchant Co. Until disposed of his patents were held primarily for sale or other disposition to customers and this situation was not different during the taxable year. He not only hoped to but did realize gains or profits from his activity as an inventor and the sale or licensing of patents on devices invented by him.

There is no merit in taxpayer's contention that the sale was not in the "ordinary course of his trade or business" because it was made to obtain greater working capital. The method of financing made available to

taxpayer very little in excess of what he had been receiving as royalties. Nor was the Gerrard Company any the less a "customer" because it had been renting the patents prior to the sale. It is not, however, necessary to pursue this contention further since it is manifest that the evidence supports the Tax Court's determination that the property was used in taxpayer's trade or business.

Taxpayer introduces into his argument a novel concept as to the administration and interpretation of the revenue laws. Taxpayer, although apparently conceding that Section 117 (a) (1) of the Revenue Act of 1938, enacted shortly after the sale here involved, was, by the terms of the Act, effective January 1, 1938, and that retroactive application of the income tax laws is constitutional, nonetheless contends that all doubts as to the meaning of the law should be resolved in his favor because of the retroactivity. Taxpayer relies on *Claridge Apartments Co. v. Commissioner*, 323 U. S. 141. This case only reiterates the well-established principle that, where there is some doubt as to the legislative intention that a law be applied retroactively, retroactivity will not be favored. But here, the statute is made applicable by its terms to "taxable years beginning after December 31, 1937" (Revenue Act of 1938, Sec. 1) ; and Section 117 (a) (1) of the Act in no uncertain terms excludes from the definition of "capital assets" "property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1)."

Taxpayer makes reference to the Committee Reports (Br. 20-22), pertaining to that language of Section 117 (a) (1) which excludes from the definition of "capital assets" "property, used in the trade or business". It is clear from a cursory reading of the Committee Reports that the language was intended as a

relief measure. Congress realized that depreciable business property was often sold at a loss and that its exclusion from the definition of capital assets would permit the taxpayer the benefit of the entire loss. This however, does not justify taxpayer's conclusion that sales of depreciable business property which result in gain were not intended to be covered by the exclusion. A reading of the Committee Reports, as set out in taxpayer's brief, clearly indicate that Congress did not expect the provision to benefit the taxpayer in all cases. Not until the Revenue Act of 1942 was passed was Section 117 (j) enacted whereby taxpayers were given the option of treating the sale of depreciable business property as a capital transaction or not, as they desired. If taxpayer's contention as to the meaning of Section 117 (a) (1) of the Revenue Act of 1938 were correct, it would hardly have been necessary for Congress to enact Section 117 (j) some four years later.

The language of Section 117 (a) (1) is unambiguous. It excludes from the definition of "capital assets" depreciable property used in a trade or business. The Tax Court's finding that the patents here involved were used in taxpayer's trade or business is amply supported by the evidence. It is not, and cannot, be questioned that patents are subject to depreciation. It therefore follows that the patents were excluded from the term "capital assets" and their sale was productive of ordinary income.

The fact that taxpayer argues in conclusion that the patents were held for investment is almost an acknowledgment of the weakness of his case. Taxpayer devoted years of effort to the development of these and other patents, secured substantial royalties for their use for about a decade, reported the income thus obtained as business income and deducted the expenses attendant upon their development as business expenses, a fact in

itself completely inconsistent with the treatment of the patents as investment assets.

II

The Tax Court properly determined that the taxpayer was not entitled to deduction or exclusion of the amount paid by taxpayer to his son for services allegedly rendered

Taxpayer's claim that he was entitled to an exclusion from the sales price of the patents in the amount of \$85,000 was naturally subject to close scrutiny by the Commissioner in view of the fact that the payment was of extraordinary size and was made to taxpayer's son for services of nebulous character. The Commissioner, having determined that the services performed by taxpayer's son, Lawrence Harvey, were of no substantial value, the burden was, of course, on the taxpayer to overcome the presumption in favor of the validity of this determination. The Tax Court found that taxpayer had failed to sustain the burden, and properly so, for the evidence offered by taxpayer fell far short of proving that Lawrence Harvey rendered any services which would entitle him to share in the proceeds of the sale.

By written contract dated subsequent to the contract of sale, taxpayer agreed to pay his son, a twenty-eight year old attorney, twenty per cent of the proceeds of the sale, or the sum of \$85,000, for services allegedly rendered in connection with the sale. The services recited in the contract were assistance in the negotiation and preparation of contracts and notes. (R. 123.) Taxpayer testified that he had an accountant and two other attorneys working on the transaction; and that one of the attorneys, Walter Sheldon, advised as to the method of handling the transaction. (R. 104.) He testified that his son was not hired in his capacity as a lawyer to draw contracts and that he had never repre-

sented taxpayer in the sale of patents. (R. 108.) At least one other attorney, Mr. Walter Sheldon, was paid a substantial attorney's fee in the year 1938. (R. 108.)

In answer to the query as to the exact nature of the services performed by Lawrence Harvey, taxpayer replied: "Well, he negotiated with people". (R. 108.) The unsatisfactory nature of the evidence adduced at the trial would not support a finding that taxpayer's son was entitled to any share in the proceeds of the sale, much less the fabulous sum of \$85,000.

Taxpayer contends that since an expense in connection with a sale is an exclusion rather than a deduction, the standard for determining the validity of the exclusion is whether it is bona fide, not whether it is ordinary, necessary and reasonable. It is hardly necessary to take issue with this proposition. The question of the reasonableness of the payment of \$85,000 to taxpayer's son and the bona fides of the transaction are not disassociated. Indeed, the payment of the sum of \$85,000 for the elusive services performed would indicate that the payment had its basis in the relationship between father and son, rather than in the performance of services, and that the exclusion was not bona fide.

Taxpayer argues that although Lawrence Harvey was only twenty-eight, many of the greatest accomplishments have been made by young men such as Keats, Einstein and Hutchins. Whether those men ever obtained \$85,000 for such intangible services as here is open to question. At any rate, no basis was laid for the comparison. Lawrence Harvey was available as a witness, but did not take the stand. The evidence did not indicate that he had any special qualifications.

Taxpayer's contention that the Tax Court was bound to make some valuation of the services rendered by Lawrence is untenable. Cases cited by taxpayer are inapplicable. In *Helvering v. Taylor*, 293 U. S. 507,

515, the Supreme Court held only that, where the taxpayer's evidence shows the Commissioner's determination to be "arbitrary and excessive," the taxpayer is not bound "to pay a tax that confessedly he does not owe" because the evidence is not sufficient to establish the correct amount. In *Cohan v. Commissioner*, 39 F. 2d 540 (C. C. A. 2d), again it was conceded that taxpayer was entitled to the deduction involved, and the Board of Tax Appeals had refused to make an evaluation because it could not determine the exact amount with certainty. *W. D. Haden Co. v. Commissioner*, 165 F. 2d 588 (C. C. A. 5th), similarly involved a situation where, as a matter of law, taxpayer was entitled to a deduction.

The Commissioner here determined that Lawrence rendered services of no substantial value. The determination was reasonable. It is true that the Tax Court stated in its opinion that Lawrence rendered some assistance to the taxpayer, but the Tax Court did not conclude that the assistance was substantial or valuable. Indeed, the Tax Court described the services as "nebulous." The record supports the conclusion that Lawrence rendered no services of value. Taxpayer cannot expect the Tax Court to carry his burden of proof. This Court in *Hughes v. Commissioner*, 104 F. 2d 144, held that where a taxpayer submitted no evidence of value, the refusal of the Board of Tax Appeals to permit taxpayer to adduce additional evidence was not an abuse of discretion where the reason may have been that such evidence was available in ample time to present it to the Board before it made and filed its findings of fact and opinion. There too, taxpayer relied on *Helvering v. Taylor*, *supra*, and this Court said (p. 148):

That case is not in point here because the taxpayer had not shown that his interest in the trust

had a value. * * * In the absence of proof of the value, the rule in *Helvering v. Taylor*, 293 U. S. 507, * * * is not applicable, because it is not shown that the Board's decision was wrong.

III

The Tax Court properly determined that taxpayer had failed to prove that his brother had any property interest in the patents

The only question for the Tax Court in this connection was whether Herbert Harvey, taxpayer's brother, had any property interest in the patents sold so as to justify the exclusion from the sale price of any sum due Herbert Harvey. The Commissioner determined that Herbert Harvey had no such interest. The record is devoid of any evidence indicating that Herbert Harvey had any interest in the property or performed any services in connection with the sale. Admittedly, Herbert performed services in the development of the patents, but during that period he was in the continuous employ of taxpayer. (R. 97.) Herbert's compensation during this period varied from \$500 to \$1,500 a month. (R. 98.) The fact that he worked on the patents and that part of his compensation was paid out of the royalties does not indicate that he had any property interest in them. Nothing in the record shows that any of the patents were in Herbert's name. The contract of sale provided that Herbert Harvey disposed of his interest in the patents, *if any*. (R. 121.) There was no evidence to indicate that there was any oral agreement between taxpayer and Herbert acknowledging that the latter had any property interest in the patents. Although taxpayer's counsel put the question to the taxpayer directly, taxpayer did not testify that any property interest in the patents was acknowledged as belonging to his brother. (R. 80.) The record would indicate that Herbert had been adequately compensated for any services rendered

in prior years. The Tax Court properly held that the Commissioner's determination in this connection must also be sustained because taxpayer "failed to establish the payments to Herbert as either exclusions or deductions from the sales price." (R. 49.) Nor was the Tax Court bound to afford the taxpayer a second opportunity to adduce the evidence necessary to sustain his burden after its findings and opinion had been filed. *Hughes v. Commissioner, supra.*

IV

The Tax Court did not err in denying taxpayer's motion for a judgment on the pleadings

Taxpayer's contention that judgment on the pleadings should have been rendered for him is not only lacking in merit, but would, if sustained, subvert the drawing of pleadings to a game of mental gymnastics between counsel, having as its objective the entrapment of opposing counsel.

Stripped of the superfluous, taxpayer's contention may be restated as follows: Taxpayer, in his petition, by way of negative allegation, denied that the patents were "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business", similarly denying the applicability of the other exceptions to the definition of "capital assets." As should be expected, under the circumstances of the case, the Commissioner in his answer entered denial to these negative allegations, in order to put the taxpayer to proof. Taxpayer contends that the denial of his negative allegation was the equivalent of an affirmative allegation by the Commissioner that the property was "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"; and that by implication the Commissioner alleged that the sale was therefore not "casual." Taxpayer concludes

that all of the income would have been taxable in the year of sale and none of it would be taxable in the years here involved, except for the fact that the sale being "casual" under Section 44 (b) (Appendix, *infra*), the profits could be treated on the installment basis; and that therefore the Commissioner's denial amounted to an admission that no tax was due in the taxable years here involved.

Taxpayer, in making this contention, misconceives the basic purpose of pleadings. When the Commissioner denied taxpayer's negative allegation he did so in order to put the taxpayer to proof. It was not necessarily intended to allege the affirmative; and it was certainly never intended to allege impliedly or otherwise that the sale was or was not "casual" within the meaning of Section 44 (b). The applicability of Section 44 had never been put in issue. Taxpayer's right to return part of the proceeds of the sale in years subsequent to the sale was not in issue. Taxpayer, in his own petition, did not allege that the profits of the sale were only returnable in the year of sale and yet he requested a motion for a judgment on the pleadings, based on the theory that any income returnable was returnable only in the year of sale.

In order to have rendered judgment on the pleadings, the Tax Court would have had to determine such matters as whether the profits from the sale of the patents were returnable in the years subsequent to the sale under Section 44 (b); whether they were so returnable under any other section of the revenue laws; if not, whether the taxpayer having elected to return the profits in the years subsequent to the sale could have at the time of the trial alleged that they were only returnable in the prior year. But these matters were not in issue between the parties. It is most important to keep in mind that taxpayer, in his petition for redetermina-

tion of the deficiency did not claim that the income was only returnable in the year of sale or conversely that none was returnable in subsequent years. It is therefore obvious that the Commissioner never intended to admit or deny anything in this respect. It is well settled that the pleadings filed with the Tax Court define and limit the issues which will be considered by that court. *Roberts v. Commissioner*, 19 B. T. A. 351; *Dastague v. Commissioner*, 19 B. T. A. 1324; *Popular Price T. Co. v. Commissioner*, 33 F. 2d 464 (C. C. A. 7th); *Hanby v. Commissioner*, 67 F. 2d 125 (C.C.A. 4th).

Taxpayer's contention, in short, was that the Commissioner by denying taxpayer's negative allegation not only admitted the affirmative but admitted by implication another ultimate fact which was not even in issue in the case.

Even assuming that the approach taken by taxpayer to reach his conclusion were not defective in its inception, his conclusion would nonetheless be untenable since the basic premise is false. Even if the Commissioner's pleadings amounted to an admission that the sale was not "casual", the income might still be returnable on an installment basis in the years involved under Section 44 (a) (Appendix, *infra*), which allows taxpayers, who regularly sell personal property on an installment basis, to report their income accordingly. As far as the pleadings were concerned, this section might have been applicable to taxpayer. In this connection it should be noted that taxpayer amended his pleadings to allege that he was not a dealer who regularly sold personal property on the installment basis, and this allegation was denied by the Commissioner. Since, as taxpayer so ardently contends, allegations which are denied must be deemed false for the purposes of a motion for judgment on the pleadings, it would follow that taxpayer's allegation that he was not such a

dealer as is described in Section 44 (a) must be deemed false and the income could have been returned in the years subsequent to the sale whether or not it was "casual". It should be noted in this connection that the Commissioner never admitted or denied the applicability of subsection (b) of Section 44 but admitted only that taxpayer elected to report the income under Section 44 (b).

Taxpayer in his argument has laid emphasis on the alleged inconsistency in the pleadings of the Commissioner. It is clear that as far as the pleadings went there was no inconsistency. It is also clear that the alleged inconsistency was between a matter not even in issue in the case and the purported implication of the Commissioner's denial of the taxpayer's negative allegation. At any rate, where the legal effect of a factual situation, or the proper interpretation of a statute is not clear, the Commissioner has no choice but to assert the liability arising from the several reasonable interpretations even though they be inconsistent. See *First Nat. Bank of Wichita Falls, Trustee v. Commissioner*, 3 T. C. 303; *Estate of Sanford v. Commissioner*, 308 U. S. 39.

The purpose of pleadings is to properly place the real issues in the case before the court. The pleadings in this case accomplished that objective and the court properly determined that since there were contested questions of fact essential to a determination of the case, a trial was necessary.

Over a century ago the Supreme Court laid down the beneficent rule, since adhered to, that courts should not decide a cause on a slip in pleading or the inadvertence of counsel except where some rule of law, the observance of which is essential to the administration of justice, requires it. *Sheehy v. Mandeville*, 11 Cranch

207. More recently the same Court stated in *Maty v. Grasselli Co.*, 303 U. S. 197, 200:

Pleadings are intended to serve as a means of arriving at fair and just settlements of controversies between litigants. They should not raise barriers which prevent the achievement of that end.

In final analysis, taxpayer's contention is nothing but a supertechnical quibble which would have been of extremely doubtful validity even under the system of rigid common law pleadings.

CONCLUSION

The judgment of the Tax Court should be affirmed.

Respectfully submitted,

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OCTOBER, 1948

APPENDIX

Internal Revenue Code: (as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—(1) *Trade or Business Expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *

* * * * *

(2) *Non-Trade or Non-Business Expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 44. INSTALLMENT BASIS.

(a) *Dealers in Personal Property.*—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed, bears to the total contract price.

(b) *Sales of Realty and Casual Sales of Personality*.—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding \$1,000, or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price * * *, the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section * * *.

(26 U. S. C. 1946 ed., Sec. 44.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

* * * * *

(b) *Adjusted Basis*.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General Rule*.—Proper adjustment in respect of the property shall in all cases be made—

(A) For expenditures, receipts, losses, or other items, properly chargeable to capital account, * * *

(26 U. S. C. 1946 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions*.—As used in this chapter—

(1) *Capital Assets*.—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inven-

tory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1) ; * * *

* * * * *

(26 U. S. C. 1946 ed., Sec. 117.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23(1)-7. *Depreciation of patent or copyright.*—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. If the patent or copyright was acquired from the Government, its cost consists of the various Government fees, cost of drawings, experimental models, attorneys' fees, development or experimental expenses, etc., actually paid. Depreciation of a copyright can be taken on the basis of the fair market value as of March 1, 1913, only when affirmative and satisfactory evidence of such value is offered. Such evidence should whenever practicable be submitted with the return. If the patent becomes obsolete prior to its expiration, such proportion of the amount on which its depreciation may be based as the number of years of its remaining life bears to the whole number of years intervening between the basic date and the date when it legally expires may be deducted, if permission so to do is specifically secured from the Commissioner. Owing to the difficulty of allocating to a particular year the obsolescence of a patent, such permission will be granted only if

affirmative and satisfactory evidence that the patent became obsolete in the year for which the depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

No. 11823

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LEO M. HARVEY and LENA P. HARVEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONERS.

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FILED

DEC 6 - 1948

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No. 11823
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

LEO M. HARVEY and LENA P. HARVEY,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

REPLY BRIEF FOR PETITIONERS.

The argument of the Respondent in his opening brief presents the following *hiatus* which he has failed to explain.

As was set forth in Petitioner's original brief, the sale to Gerrard occurred on March 21, 1938, at which time Petitioner received \$25,000 in cash and ten negotiable promissory notes, each in amount and having a fair market value of \$40,000, maturing serially commencing April 2, 1939, through April 2, 1948. The Petitioners regularly reported income on the accrual basis and under proper accounting practice and the provisions of Sections 41 and 42 of the Internal Revenue Code, all of the gain from the sale *accrued* in the year of the sale, 1938, unless the transaction qualified as an installment sale under Section 44 of the Internal Revenue Code. From the facts

in the case, it is clear that the sale did not qualify as an installment sale under Section 44(a), but in preparing their returns for 1938 and subsequent years, Petitioner took the position that the transaction constituted a *casual* sale of personal property and could be reported by installments under Section 44(b). If the Court should determine that the sale of patents to Gerrard was not a *casual sale*, all income from the sale would have been realized by the Petitioner in 1938, and could be taxed only in the year realized. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 75 L. Ed. 383; *Georgia School-Book Depository, Inc.*, 1 T. C. 463; *Acme Coal Co. v. United States*, 70 Ct. Cls. 696, 44 F. 2d 95.

The Respondent contends, at pages 13 and 14 of his brief, that the sale of patents to Gerrard was a sale of property held by Petitioner primarily for sale to customers in the ordinary course of taxpayer's trade or business. The Commissioner, in a published ruling, has held that such a sale is not a *casual* sale under a section of the revenue law comparable to 44(b) of the Internal Revenue Code. G. C. M. 1162 VI-1, C. B. 22. Consequently, if the Commissioner should establish that the sale of patents was a sale of property held primarily for sale to customers in the ordinary course of taxpayer's trade or business, he would at the same time establish that the sale was not a *casual* sale for which income may be deferred on the installment basis under Section 44(b). Consequently, all of the income which was realized in 1938 could only be taxable to the Petitioner in the year 1938, a year not before the Court.

The Motion for Judgment on the pleadings filed in the Tax Court and the subsequent amendment to the Petition before the Tax Court advised the Respondent of the above

hiatus in his position prior to the trial in the Tax Court. Even assuming, as Respondent suggests, that the *hiatus* should not have been resolved on the pleading, nevertheless it would appear that this Court must resolve the *hiatus* in reaching a decision.

Respondent, in its brief, also takes the position that the sale of patents by Petitioner was a sale of property used in Petitioner's trade or business as an inventor. This, of course, presumes that Petitioner was in the trade or business of inventing, and that such patents were used in such trade or business. Both presumptions appear to be unsupported by the facts. From the Record, it appears that during the period from 1913 until 1938, Petitioner patented not more than four or five inventions, and the ones in question are the only ones he ever sold. It does not appear that he devoted a great deal of time to such inventions. If the activity of the Petitioner in making one sale of an invention during the period of his life, is a *casual* sale under Section 44(b), how can the Respondent contend that Petitioner engages in sufficient inventive activities to be engaged in that trade or business? Casual sales are not sufficient to constitute carrying on a trade or business. *Greenwood*, 34 B. T. A. 1209; *M. E. Trapp v. United States*, (D. Ct. W. D. Okla.) 485 C. C. H. 9371.

Nor is the fact that Petitioner sold a patent created by his own personal services sufficient to make the sales price ordinary income rather than capital gain. It is established that an inventor may realize capital gain from the sale of his own invention. *Carl G. Dreymann*, 11 T. C. No. 23, (August 9, 1948); and see Bureau Acquiescence, 1946—1 C. B. 3 in the case of *Edward C. Meyers*, 6 T. C. 258; also, as pointed out by the Supreme Court in *Eugene Higgins v. Commissioner*, 312 U. S. 212, 85 L. Ed. 783,

the mere fact that activity is engaged in for a profit does not mean that such activity constitutes the carrying on of a trade or business. The possibility of profit is the customary motive which prompts people to maintain, conserve and sell property.

It would appear that the recent decisions of the Tax Court in *Carl G. Dreymann*, 11 T. C. No. 23 (August 9, 1948), is most persuasive in determining the issue herein presented. In that case, Petitioner was a chemist and consulting engineer who earned his living by chemical and engineering research. Mr. Dreymann, while in the business of manufacturing certain products out of fish oil, invented a process for substituting fish oil in the manufacture of steel. This patent, he sold to United States Steel Corporation. During the period from 1931 to 1942, apparently Mr. Dreymann devoted almost his entire time to the development of a process for moisture-proofing paper and paper board. He obtained certain patents on such processes. The record in the *Dreymann* case is replete with evidence of his continuous activity over many years regarding this invention. The Tax Court found that in 1935 Petitioner sold this patent after devoting approximately four years to research and development. The Tax Court determined that the income received by Dreymann for the sale of the patents for moisture-proof paper was capital gain and not ordinary income because Dreymann was not in the trade or business of being an inventor. It would appear that the personal service activities of Mr. Dreymann in creating the patent which

was sold, were much more extensive than any activities of this Petitioner.

It is also important to note that in the *Dreymann* case, the Court found that his 19-year-old daughter, a high school graduate, had an undivided one-half equitable interest in the patent because of services which she rendered in assisting Mr. Dreymann in creating the patent. All patents were in the name of Dreymann and the daughter did not have any legal interest in the patents. It would appear that the Tax Court should have held that Herbert Harvey had an equitable interest in Petitioner's patents. The evidence amply supports such a finding.

Respondent has contended that the burden was on Petitioner to establish that the 20% compensation to Lawrence Harvey for services rendered was reasonable. Such a position is hardly consistent with the position which Respondent's attorneys took at the Tax Court hearing wherein he objected on the ground of immateriality to a question asked Petitioner relating to the extent and nature of services rendered by Lawrence [R. 74]:

"We have no question here as to the reasonableness of any compensation paid to Lawrence Harvey."

It is respectfully submitted that Petitioner receive the relief as prayed for in Petitioner's opening brief.

Respectfully submitted,

CHARLES H. CARR,

BRYANT R. BURTON,

Attorneys for Petitioners.

No. 11,824

IN THE
United States
Circuit Court of Appeals
For the Ninth Circuit

THOMAS JOEL WRIGHT,
Appellant,

vs.

UNITED STATES OF
AMERICA,

Appellee.

FILED

MAR 15 1948

PAUL P. O'BRIEN, CLERK

BRIEF FOR APPELLEE

FRANK E. FLYNN,
*United States Attorney
For the District of Arizona*

E. R. THURMAN,
*Assistant United States
Attorney for the
District of Arizona*

204 U. S. Federal Building
Phoenix, Arizona

Attorneys for Appellee

IN THE
United States
Circuit Court of Appeals
For the Ninth Circuit

THOMAS JOEL WRIGHT,	}
Appellant,	
vs.	
UNITED STATES OF	}
AMERICA,	
Appellee.	

BRIEF FOR APPELLEE

FRANK E. FLYNN,
United States Attorney
For the District of Arizona

E. R. THURMAN,
Assistant United States
Attorney for the
District of Arizona

204 U. S. Federal Building
Phoenix, Arizona

Attorneys for Appellee

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IN THE
United States
Circuit Court of Appeals
For the Ninth Circuit

THOMAS JOEL WRIGHT,	}
Appellant,	
vs.	
UNITED STATES OF AMERICA,	}
Appellee.	

BRIEF FOR APPELLEE

STATEMENT OF CASE

The indictment charged the appellant with transporting and causing to be transported in interstate commerce, a falsely made, forged and counterfeited security, to-wit, a bank check. The facts in the case are not in dispute. The check was drawn and cashed in Phoenix, Arizona, on the Walker Bank and Trust Company, Salt Lake City, Utah. The check, in the usual course of business, was transported in interstate commerce from Phoenix to Salt Lake City, Utah. The appellant had no funds or credit at the Walker Bank

and Trust Company, and payment on the check was refused. There is also no dispute of the fact that the check bore the true signature of the appellant.

QUESTIONS PRESENTED

Appellant contends that the check, being drawn in the true name of the appellant as maker, was neither falsely made, forged, altered nor counterfeited, and therefore not within the scope of the statute.

The three assignments of error are all based upon the contention of the appellant just stated.

ARGUMENT

We submit that in order to sustain the government's position in this case, it is immaterial whether we consider the check in question *falsely made* or *forged*. Therefore, we do not consider it necessary to indulge in a long technical argument on the legal difference between a falsely made security and a forged security. We believe that the security in question was both falsely made and forged.

Williams v. Territory, 13 Ariz. 27
(108 Pac. 243)

Buckner v. Hudspeth, 105 F. (2d) 393
(10th C.C.A.)

Hart v. Squier, 159 F. (2d) 639
(9th C.C.A.)

In the *Williams* case (*supra*) the question was squarely before the Arizona Supreme Court. It was contended by the appellant in that case that a check bearing the genuine signature of the maker was a genuine check and was neither false nor bogus. In an opin-

ion in which the authorities on the interpretation of the words "false" and "bogus" were thoroughly explored, the Arizona Supreme Court held that the check was both false and bogus. We quote from that opinion (page 33):

"It is sufficient for the purpose of this case to hold that a check is 'false' within the statute when it is a wilfully untrue written order directing a bank to pay money on demand."

In the case of *Buckner vs. Hudspeth* (supra) the Court, in discussing a check signed with a fictitious name, said:

"It may be wholly fictitious if the instrument is made with intent to defraud and shows on its face that it has sufficient efficacy to enable it to be used in the injury of another." (Citing *Meldrun vs. U. S.*, 9th C.C.A., 151 Fed. 177).

In the 9th Circuit case of *Hart vs. Squier* (supra), the defendant gave a fictitious name to a physician and was issued a narcotic prescription. He was charged with uttering and publishing a false and forged writing for the purpose of defrauding the government. We quote the following from the opinion, page 640:

"The narrow inquiry, therefore, is: Is the prescription 'false' or 'forged' within the meaning of the statute? To state the question is to answer it, for under the allegation of the indictment, the name on the prescription is not appellant's true name, but is assumed, fictitious—false. We need not decide whether this is forgery or not."

Blackstone defined forgery to be "the fraudulent making or alteration of a writing to the prejudice of another's right." *State vs. Wheeler*, 25 Pac. 394. We take the following quotation from the opinion of Judge Bean in the last cited case:

“The making or alteration of any writing with a fraudulent intent whereby another may be prejudiced, is forgery.”

“The question of intent is material in determining the guilt of the party charged, and the falsity of the instrument. It is the false making with an intent to defraud at which our statute is aimed.”

“A person may falsely make a note if the note be true in point of fact.”

It was the intention of Congress in passing the law which appellant is charged with violating, to protect the general public from being defrauded by the use of false and fictitious securities. If we keep this purpose in mind, we have no difficulty in arriving at the conclusion that the activities of appellant were in violation of that law.

The appellant's argument and the authorities cited in support thereof, are all answered in the opinion of the Supreme Court in the case of *United States vs. Staats*, 8 Howard 41, cited in appellant's brief at page 6. We take the following quotation from that case:

“A genuine instrument containing a false statement of facts, used in support of a claim, the party knowing it to be false, and using it with the intent to defraud, presents a case not distinguishable in principle, or in turpitude, or in its mischievous effects, from one in which every part of the instrument is fabricated; and when the one is as fully within the words of the statute as the other, we may well suppose that it was intended to embrace it.”

In the case of *U. S. vs. Sheridan*, 329 U. S. 379, the question in the present case was not before the Supreme Court. The only issues before the court involved Counts I and II. These two counts were sufficient to sustain the conviction and justify the sentence. Therefore, it

was not considered necessary by the government to urge a consideration of Count III.

CONCLUSION

The check in the present case meets all of the conditions and requirements set out in the authorities hereinbefore cited.

The check was *made* by the appellant with the intent to defraud. It was a false and fictitious check in that it was drawn on an account and against a credit that did not exist. There is no difference between drawing a check on a fictitious account or credit and drawing a check in a fictitious name or on a bank that does not exist. One is just as false and fictitious as the other, the purpose and intent being in each instance to defraud.

We therefore submit that the judgment should be affirmed.

Respectfully submitted,

FRANK E. FLYNN,
United States Attorney
for the District of Arizona

E. R. THURMAN,
Assistant United States Attorney

No. 11826

United States
Circuit Court of Appeals
For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ESTATE OF DANIEL GARTLING, Deceased,
R. N. Weaver, Executor,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court
of the United States

FILED

MAY 21 1901

PAUL P. O'BRIEN,

CLERK

No. 11826

United States
Circuit Court of Appeals
For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

VS.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

D. WEBSTER EGAN, Esq.,

For Commissioner:

A. J. HURLEY, Esq.

Docket No. 8795

DANIEL GARTLING,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Amended Caption: Mar. 26, 1947 - Estate of
Daniel Gartling, Deceased, R. N. Weaver,
Executor.

DOCKET ENTRIES

1945

- July 23 Petition received and filed. Taxpayer notified. Fee paid.
- July 23 Copy of petition served on General Counsel.
- Aug. 24 Answer filed by General Counsel.
- Aug. 24 Request for hearing in Los Angeles, Calif. filed by General Counsel.
- Aug. 27 Notice issued placing proceeding on Los Angeles, Calif. calendar. Service of answer and request made.

1946

- Dec. 6 Hearing set February 10, 1947, Los Angeles, California.
- Oct. 15 Motion to substitute name of executor for petitioner, filed by taxpayer.

1947

- Feb. 10 Hearing had before Judge Leech on merits. Stipulation of facts and certified copies of letters of testamentary filed at hearing. Petitioner's brief filed Feb. 10, 1947, and copies served on respondent. Respondent's brief due 3/24/47. Petitioner's reply due 4/10/47.
- Mar. 5 Transcript of hearing filed. Los Angeles, Calif. Feb. 10, 1947.
- Mar. 24 Reply brief filed by General Counsel.
- Mar. 26 Order that caption of the above proceeding be amended to read, "Estate of Daniel Gartling, Dec'd., R. N. Weaver, Executor," now for then, entered.
- Apr. 14 Reply brief filed by taxpayer. Copy served.
- July 28 Memorandum opinion rendered, Judge Leech. Decision will be entered under Rule 50. Copy served.
- Aug. 27 Respondent's computation for entry of decision filed.
- Aug. 29 Hearing set September 24, 1947 on settlement.
- Sept. 4 Consent to settlement filed.
- Sept. 5 Decision entered. Judge Leech. Div. 6.
- Nov. 28 Petition for review by U. S. Circuit Court of Appeals, Ninth Circuit, with assignments of error filed by General Counsel.
- Dec. 9 Proof of service of petition for review on R. N. Weaver, Executor, filed.

1947

- Dec. 9 Proof of service of petition for review on Attorney for taxpayer filed.
- Dec. 15 Statement of points filed by General Counsel with proof of service thereon.
- Dec. 15 Agreed designation of portions of the record to be printed filed.
- Dec. 15 Designation of record filed by General Counsel with service admitted thereon. [1*]
-

The Tax Court of the United States
Docket No. 8795

DANIEL GARTLING,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION

The above-named petitioner hereby appeals from the determination of the Commissioner of Internal Revenue, set forth in his deficiency letter, (LA-IT-90D-PB), dated May 17th, 1945, and as the basis of his appeal sets forth the following:

I.

That petitioner is a resident of the City of Los Angeles, County of Los Angeles, State of California.

* Page numbering appearing at foot of page of Reporter's certified Transcript of Record.

II.

That the deficiency letter (a copy of which is attached), was mailed to petitioner on May 17th, 1945, and states a deficiency of \$2590.87.

III.

That the taxes in controversy are federal income tax for the calendar year 1941.

IV.

That the determination of the taxes contained in said deficiency letter is based upon the following errors.

- (a) The respondent proposes to assess a tax on a net gain [2] of \$13,321.00, resulting from the sale of one-sixth ($1/6$), interest of taxpayer's three-sixth's ($3/6$'s), interest in and to the property and assets of the California Well Tool & Machine Works, a partnership to each Dorothy J. West and Wm. M. Craft.
- (b) That one-half of net gain, to wit, \$6660.50, only is subject to tax the sale in question being a long-term capital gain.

V.

The facts upon which petitioner relies as the basis of his appeal are as follows:

That during the year 1941, taxpayer sold to Dorothy J. West and Wm. M. Craft, two-sixth's ($2/6$'s), of his undivided three-sixth's ($3/6$'s), interest in and to the property and assets of the

California Well Tool & Machine Works, a partnership, for the sum of \$24,000.00, resulting in a net gain of the sum of \$13,321.00.

Wherefore, petitioner prays that this Court determine that one-half only of the net gain of the sum of \$13,321.00, is subject to tax for the calendar year 1941.

DANIEL GARTLING,
Petitioner.

D. WEBSTER EGAN,
Attorney for petitioner,
403 West 8th Street,
Los Angeles 14, Calif.

State of California,
County of Los Angeles—ss.

Daniel Gartling, being first duly sworn, on oath, deposes and says; that he is the petitioner in the above-entitled appeal; [3] that he has read the foregoing petition and knows the contents thereof; that the same is true of his own knowledge, except as to the matters which are therein stated on information and belief and as to those matters that he believes it to be true.

DANIEL GARTLING,

Subscribed and sworn to before me this 12th day of July, 1945.

FRANK LOBER,
Notary Public in and for the County of Los Angeles, State of California. [4]

(Copy)

Treasury Department, Internal Revenue Service,
417 South Hill Street, Los Angeles 13, California.

May 17th, 1945

Office of Internal Revenue Agent in Charge, Los
Angeles Division. LA: IT: 90D-PB.

Mr. Daniel Gartling,
5133 Highland View Avenue,
Los Angeles 14, California.

Dear Mr. Gartling:

You are advised that the determination of your income tax liability for the taxable year ended December 31st, 1941, discloses a deficiency of \$2,-590.87, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day), from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los Angeles, California, for the attention of LA: Conf. The signing and filing of this form will expedite the closing of your return (x), by permitting an

early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, Jr.,

Commissioner,

By GEORGE D. MARTIN,

Internal Revenue Agent in
Charge.

Enclosures

Statement

Form of waiver.

Statement

LA:IT:90D-PB Mr. Daniel Gartling,
5133 Highland View Avenue,
Los Angeles 14, California.

Tax Liability for the Taxable Year Ended December 31, 1941.

	Liability	Assessed	Deficiency
Income Tax.....	\$4596.60	\$2005.73	\$2590.87

In making this determination of your income tax liability careful consideration has been given to the report of examination dated August 28, 1944, to your protest dated October 25, 1944, and to the statements made at the conference held.

A copy of this letter and statement has been mailed to your representative Mr. D. Webster Egan, 403 West 8th Street, Los Angeles 14, California, in accordance with the authorization contained in the power of attorney executed by you.

Adjustment of Net Income

Net income as disclosed by return.....	\$ 5,782.82
Additional income: Gain from sale.....	13,321.00
	<hr/>
	\$19,103.82

Explanation of Adjustment

The gain resulting from the sale one-sixth ($1/6$) interest of your three-sixth ($3/6$), interest in and to the property and assets of the California Well Tool & Machine Works, to each Dorothy J. West and Wm. M. Craft, in the amount of \$13,321.00, has been held to represent ordinary income includible in taxable income in the full amount. [6]

You did not report this transaction in your return, but in an amended return filed on July 9th, 1943, you reported a long-term capital gain of \$5,993.83 from this sale.

Computation of Tax

Net Income adjusted.....	\$19,103.82
Less: personal exemption.....	750.00
	<hr/>
Balance (surtax net income).....	\$18,353.82
Less: earned income credit.....	300.00
	<hr/>
Net income subject to normal tax.....	\$18,053.82
Normal tax at 4% on \$18,053.82.....	\$ 722.15
Surtax on \$18,353.82.....	3,874.45
Total income tax.....	\$ 4,596.60
Correct income tax liability.....	\$ 4,596.60
Income tax assessed	
Original, account No. 939694.....	\$ 623.58
Amended, account No. Oct. 900560.....	1,382.15
	<hr/>
Deficiency of income tax.....	\$ 2,590.87

Received and filed July 23, 1945,

[Title of Tax Court and Cause.]

ANSWER

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I, II, and III.

Admits the allegations contained in paragraphs I, II, and III of the petition.

IV (a) and (b).

Denies the allegation of error contained in subparagraphs (a) and (b) of paragraph IV of the petition.

V.

Admits the allegations contained in paragraph V of the petition.

VI.

Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied. [8]

Wherefore, it is prayed that the determination of the Commissioner be approved.

/s/ J. P. WENCHEL, ECC

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

B. H. NEBLETT, Division Counsel.

E. C. CROUTER,

A. J. HURLEY,

Special Attorneys,

Bureau of Internal Revenue.

AJH:ma 8/17/45

Received and filed Aug. 24, 1945. [9]

The Tax Court of the United States

Docket No. 8795

ESTATE OF DANIEL GARTLING, Deceased,
R. N. WEAVER, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Decedent, more than 10 years prior to the taxable year 1941, acquired a three-sixths interest in a California partnership. In 1941 he sold an undivided two-sixths interest at a net gain of \$13,321. Held, a partner's interest in a partnership is a capital asset, the sale of which results in a capital gain or loss, taxable as provided in section 117, I.R.C.

D. Webster Egan, Esq., for the petitioner.

A. J. Hurley, Esq., for the respondent.

MEMORANDUM OPINION

Leech, Judge:

This controversy involves a deficiency in income tax for the year 1941 in the amount of \$2,590.87. The only issue is whether the [10] gain realized by decedent from the sale of two-sixths of an undivided three-sixths interest in a partnership is a capital gain or an ordinary gain for Federal income tax purposes. All the facts have been stipulated and are adopted as our findings of fact. They may be summarized as follows:

Petitioner is the duly appointed executor of the estate of Daniel Gartling, deceased. The decedent, a resident of the City of Los Angeles, filed his income tax return for the taxable period with the collector of internal revenue for the sixth district of California, at Los Angeles, California.

On January 2, 1941, and for many years prior thereto, the decedent was the owner of an undivided three-sixths interest in the copartnership of California Well Tool and Machine Works organized under the laws of the State of California. On January 2, 1941, the decedent sold two-thirds of his three-sixths interest in such partnership for the sum of \$24,000. The decedent's cost basis of the interest sold was \$10,679, resulting in a net profit of \$13,321.

Petitioner contends that the sale of the fractional part of decedent's partnership interest constituted the sale of a "capital asset", and since decedent held the same for more than 10 years, only 50 per centum of such gain is to be taken into account under section 117 of the Internal Revenue Code. The respondent contends that for Federal income tax purposes a partnership is not a juristic entity, but is an association of individuals, each of whom is vested with an interest in each specific asset of the partnership. He argues that petitioner has failed to establish the nature and character of the component assets of the partnership. [11]

We think the position taken by petitioner is the correct one. The respondent concedes the law of California is controlling, and that the Uniform Partnership Act has been adopted and is in force in that state.

In the recent case of *George Whitney*, 8 T.C. (May 14, 1947), we passed upon the nature of a partnership interest. We there held that the partnership and not the individual partners owned the partnership assets. We said:

* * * The interests of the several partners in the partnership were merely the respective shares of the profits and surplus, less its obligations. *New York Partnership Law*, sec. 52.¹ Cf. *Robert E. Ford*, 6 T.C. 499;⁴ *Allan S. Lehman*, 7 T.C. 1088; *Blodgett v. Silberman*, 277 U.S. 1; *Case v. Beauregard*, 99 U.S. 119. * * *

A partnership interest has repeatedly been held to be a capital asset. *Commissioner v. Shapiro*, 125 Fed. (2d) 532; *Stilgenbaur v. United States*, 115 Fed. (2d) 283; *Dudley T. Humphrey*, 32 B.T.A. 280; *Allan S. Lehman*, 7 T.C. 1088. The decedent having sold only an undivided portion of his partnership interest, the gain resulting therefrom is a capital gain. The holding period was in excess of 10 years. Under section 117 of the Code, only 50 per centum of such gain is taxable. The stipulated net gain realized by the decedent, by reason of respondent's adjustment to decedent's cost basis, is in excess of that reported on his income tax return for the taxable year involved; therefore

Decision will be entered under Rule 50.

Entered July 28, 1947. [12]

¹ Sec. 26, Uniform Partnership Act, in effect in California, is the same as Sec. 52, N.Y. Partnership Law.

⁴ Respondent acquiesces, C.B. 1946-2, p. 2.

The Tax Court of the United States
Washington

Docket No. 8795

ESTATE OF DANIEL GARTLING, Deceased,
R. N. Weaver, Executor,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Opinion of the Court entered in the above-entitled proceeding July 28, 1947, the respondent having filed his computation herein on August 27, 1947, and the petitioner having filed his acquiescence therein on September 4, 1947, it is hereby

Ordered and decided: That there is a deficiency in income tax for the year 1941 of \$193.33.

Enter:

[Seal] /s/ J. RUSSELL LEECH,
Judge.

Entered Sept. 8, 1947. [13]

In the United States Circuit Court of Appeals
For the Ninth Circuit

Docket No. 8795

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,
vs.

ESTATE OF DANIEL GARTLING, Deceased,
R. N. Weaver, Executor,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States
Circuit Court of Appeals for the Ninth Circuit.

The Commissioner of Internal Revenue hereby petitions the United States Circuit Court of Appeals for the Ninth Circuit to review the decision entered by the Tax Court of the United States on September 8, 1947, ordering and deciding that there is a deficiency in income tax of \$193.33 for the calendar year of 1941. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

The decedent, Daniel Gartling, filed his individual income tax return for the calendar year 1941 with the Collector of Internal Revenue for the Sixth District of California, whose office is located at Los Angeles, California, and within the judicial circuit of the United States Circuit Court of Appeals for the Ninth Circuit, where this review is sought. [14]

Nature of Controversy

The question involved is whether the gain realized by decedent from the sale of an undivided two-sixths interest in and to the property and assets of the partnership represents capital gain or ordinary gain for Federal income tax purposes.

On January 2, 1941, and for many years prior thereto, the decedent was the owner of an undivided three-sixths interest in the copartnership of California Well Tool and Machine Works organized under the laws of the State of California. On January 2, 1941, the decedent sold two-thirds of his three-sixths interest in and to the property and assets of the said partnership for the sum of \$24,000. The decedent's cost basis of the interest sold was \$10,679, resulting in a net profit of \$13,321.

In his notice of deficiency the Commissioner held that the gain from the sale represents ordinary income includible in taxable income in the full amount. The Tax Court, however, held that a partnership interest is a capital asset, and the decedent having sold only an undivided portion of his partnership interest, the gain resulting therefrom is a capital gain, and, since the holding period was in excess of ten years, only fifty per centum of such gain is taxable under Section 117 of the Internal Revenue Code.

/s/ THERON L. CAUDLE, CAR

Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR

Chief Counsel,

Bureau of Internal Revenue,

Counsel for Petitioner on Review.

Received and filed TCUS Nov. 28, 1947. [15]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Mr. R. N. Weaver, Executor, Estate of Daniel
Gartling, Deceased.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of November, 1947, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR

Chief Counsel,

Bureau of Internal Revenue,

Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this day of December, 1947.

/s/ R. N. WEAVER,

Executor, Estate of Daniel

Gartling, Deceased,

Respondent on Review.

Received and filed TCUS Dec. 9, 1947.

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: D. Webster Egan, Esq., 403 West Eighth Street,
Los Angeles 14, California.

You are hereby notified that the Commissioner of Internal Revenue did, on the 28th day of November, 1947, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review as filed is hereto attached and served upon you.

Dated this 28th day of November, 1947.

/s/ CHARLES OLIPHANT, CAR

Chief Counsel,

Bureau of Internal Revenue,

Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review, is hereby acknowledged this 1st day of December, 1947.

/s/ D. WEBSTER EGAN,

Counsel for Respondent on
Review.

Received and filed Dec. 9, 1947. [17]

The Tax Court of the United States

Docket No. 8795

ESTATE OF DANIEL GARTLING, Deceased,
R. N. Weaver, Executor,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STIPULATION OF FACTS

Petitioner and respondent in the above-entitled proceeding, through their respective counsel of record, hereby stipulate and agree upon the facts hereinafter set forth and do hereby submit said proceeding for decision upon the basis of this stipulation, without prejudice, however, to the right of either party to offer other or additional evidence not inconsistent herewith.

1. The petitioner is the duly appointed executor of the Estate of Daniel Gartling, Deceased.

2. On January 2, 1941, and for many years prior thereto the decedent, Daniel Gartling, was the owner of a one-half interest in a certain partnership organized under the laws of California and composed of the said Daniel Gartling and his brother, George Gartling. The partnership was engaged in the manufacturing of steel forgings and doing business under the name of California Well Tool and Machine Works. The assets of the partnership consisted chiefly of the plant, machinery, inventories

and accounts receivable. There is attached hereto and made a part hereof as Exhibit 1-A a copy of the balance sheet of the partnership as of December 31, 1940.

3. On January 2, 1941, the decedent sold two-thirds of his one-half interest in and to the property and assets of the said partnership to Dorothy J. West and William M. Croft for the sum of \$24,000.00. The basis to the decedent of the interest sold was \$10,679.00, resulting in a net profit on the transaction of \$13,321.00.

4. Copies of the bills of sale executed by the decedent and the parties of the second part, relative to the sale of this portion of the interest of the decedent in the assets of the partnership to Dorothy J. West and William M. Croft, are attached hereto and made a part hereof as Exhibits 2-B and 3-C respectively. There is also attached hereto and made a part hereof, as Exhibit 4-D, a copy of the new partnership agreement executed by Daniel Gartling, George Gartling, William M. Croft and Dorothy J. West.

5. The decedent in his individual income-tax return for the calendar year 1941, filed with the Collector of Internal Revenue for the Sixth Collection District at Los Angeles, failed to report the sale of any portion of his partnership interest. On July 9, 1943, however, the decedent filed with said Collector an amended return on which he reported a long-term capital gain [19] in the amount of \$5,993.83, resulting from the transaction above described.

6. The respondent in arriving at his determination reduced the basis of decedent's partnership interest as reported on his amended return by \$1,333.34 and further held that the resulting profit in the amount of \$13,321.00 represented ordinary income includible in taxable income in the full amount. It is conceded by the petitioner that the basis reported by the decedent in his amended return was erroneous and the only question remaining for decision is whether the profit resulting from the transaction should be taxed as long-term capital gain or as ordinary income.

/s/ D. WEBSTER EGAN,
Counsel for Petitioner.

/s/ J. P. WENCHELL, ECC
Chief Counsel, Bureau of Internal Revenue,
Counsel for Respondent. [20]

AJH/vp 2/5/47.

EXHIBIT 1-A

CALIFORNIA WELL TOOL AND MACHINE WORKS

Balance Sheet—December 31, 1940

Assets—Current:

Cash in Bank—Security.....	\$ 6,143.99	
Cash in Bank—Citizens.....	9,968.51	
Accounts Receivable.....	26,285.72	
Inventory—Merchandise	21,096.27	
Advance to Partners, Etc.....	3,784.20	
		<hr/>
		\$67,278.69

Assets—Fixed:

Machinery and Tools	\$112,869.35	
Machinery and Tools, Additional..	494.16	
Furniture and Fixtures.....	967.66	
Furniture and Fixtures, Additional	24.00	
		<hr/>
		\$114,355.17

Less:

Reserve for Deprec'n—			
Mach. & Tools.....	\$111,817.93		
Reserve for Deprec'n—			
Furn. & Fixts.....	757.45	112,575.38	1,779.79
	<hr/>	<hr/>	

Assets—Miscellaneous:

Petty Cash Fund.....	\$ 75.00	
Prepaid Accounts.....	179.56	
Insurance Deposit	341.45	596.01
		<hr/>
Total Assets.....		\$69,654.49
		<hr/> <hr/>

Liabilities and Capital:

Accounts Payable	\$	3,529.32	
Accrued Payroll		326.82	
Notes Payable		1,785.35	
Notes Payable—I. D. Gartling.....		24,000.00	
State Sales Tax.....		127.88	
State Employment Department....		308.90	
Federal Social Security.....		168.36	
Accrued Federal Unemployment..		113.53	
Accrued Compensation Insurance		101.12	
		<hr/>	
Total Liabilities.....			\$30,461.28
Capital—Daniel Gartling,			
Jan. 1, 1940.....	\$	16,026.95	
Capital—Geo. L. Gartling,			
Jan. 1, 1940.....		16,026.95	
		<hr/>	
Total Investment—Jan. 1, 1940....	\$	32,053.00	
Less: Cost of Liquidating I. D. Gart-			
ling Equity.....		5,826.93	
		<hr/>	
	\$	26,226.97	
Plus: Surplus from Life			
Ins. Gross Rec'd.....	\$	10,000.00	
Less: Payments to Partners	6,000.00	4,000.00	
		<hr/>	
Total	\$	30,226.97	
Plus: Undivided Surplus,			
Jan. 1, 1940–Dec. 31, '40..	\$	11,474.64	
Less: Dividend Paid—			
I. D. Gartling.....	2,508.40	8,966.24	39,193.21
		<hr/>	
Total Liabilities and Capital.....			<u>\$69,654.49</u>

EXHIBIT 2-B
BILL OF SALE

This agreement made and entered into this 2nd day of January, 1941, by and between Daniel Gartling, party of the first part and Dorothy J. West party of the second part.

Witnesseth:

Whereas, Daniel Gartling, is the owner of an undivided three-sixths ($3/6$), interest in and to all of the property and assets of the California Well Tool & Machine Works, a partnership, doing business in the City of Los Angeles, County of Los Angeles, State of California.

Now, therefore, for and in consideration of the sum of twelve thousand (\$12,000.00), dollars, the party of the first part, does by these presents grant, bargain, sell and convey unto the party of the second part, his executors, administrators and assigns an undivided one-sixth ($1/6$), interest in and to the property and assets of the California Well Tool & Machine Works, a partnership, doing business at Los Angeles, California.

It is understood and agree by the parties hereto that said indebtedness, shall be evidenced by a promissory note in the principal sum of twelve thousand (\$12,000.00) dollars bearing interest at the rate of five (5%), per cent per annum and payable out of second party's profits earned from this undivided interest in and to all of the property and assets of the California Well Tool & Machine Works, a partnership.

DANIEL GARTLING.
DOROTHY J. WEST.

EXHIBIT 3-C
BILL OF SALE

This agreement made and entered into this 2nd day of January, 1941, by and between Daniel Gartling, party of the first part and Wm. M. Croft, party of the second part.

Witnesseth:

Whereas, Daniel Gartling, is the owner of an undivided three-sixths ($3/6$), interest in and to all of the property and assets of the California Well Tool & Machine Works, a partnership, doing business in the City of Los Angeles, County of Los Angeles, State of California.

Now, therefore, for and in consideration of the sum of twelve thousand, (\$12,000.00), dollars, the party of the first part, does by these presents grant, bargain, sell and convey unto the party of the second part, his executors, administrators and assigns an undivided one-sixth ($1/6$), interest in and to the property and assets of the California Well Tool & Machine Works, a partnership, doing business at Los Angeles, California.

It is understood and agreed by the parties hereto that said indebtedness, shall be evidenced by a promissory note in the principal sum of twelve thousand (\$12,000.00) dollars bearing interest at the rate of five (5%), per cent per annum and payable out of second party's profits earned from this undivided interest in and to all of the property and assets of the California Well Tool & Machine Works, a partnership.

DANIEL GARTLING.
WM. M. CROFT. [21]

EXHIBIT 4-D
ARTICLES OF CO-PARTNERSHIP

This agreement made this 2nd day of January 1941, by and between Daniel Gartling, George L. Gartling, William Croft, and Dorothy J. West.

Witnesseth:

Whereas, Daniel Gartling and George L. Gartling are the remaining partners of the California Well Tool & Machine Works, a partnership, by reason of the death of Ida D. Gartling, and

Whereas, the said Daniel Gartling and George L. Gartling, have agreed to admit as incoming partners William Croft and Dorothy J. West.

Now, therefore, it is agreed by said parties as follows:

That said partnership shall commence on the 2nd day of January 1941, and continue until the 2nd day of January 1946, unless terminated by mutual consent or by death of any of the partners.

That the book value of the capital of said partnership as of January 1st, 1941, is the sum of \$36037.01, of which Daniel Gartling is the owner of \$18018.51 and George L. Gartling is the owner of \$18018.50, the said Daniel Gartling having sold to William Croft and Dorothy J. West two-sixths' of said mentioned undivided interest in and to the property and assets of said partnership, and by reason thereof said interests of the respective partners are as follows to-wit:

George L. Gartling, an undivided three-sixth's; Daniel Gartling, an undivided one-sixth; William Croft, an undivided one-sixth and Dorothy J. West, an undivided one-sixth.

The said partners, (with the exception of Dorothy J. West), at all times during the continuance of the partnership, shall give their attendance, and to the utmost of their skill and power exert themselves in the conduct and management of the firm's business for the joint interest, profit, benefit and advantage of all of the parties herein.

That during the continuance of said partnership all rents and other expenses that may be required for the support, management and conduct of said business shall be paid from the gross [24] income thereof, and in the event that said gross income is insufficient to pay said expenses, said partners shall bear, pay and discharge as their interest appear the balance of said expenses remaining unpaid on the first day of January of each and every year during the continuance of said partnership.

That there shall be kept at all times regular books of account of the business of said firm, and each of the partners shall have, at all times, access to all such books of accounts and the accounts of said firm, and on the first day of January, each year, a true inventory and account of all the profits and increase of the business and all losses sustained during the preceding year shall be made and submitted to each of the said partners, and the profits, if any, shall be divided as follows:

To George L. Gartling, fifty (50%) per centum thereof.

To Daniel Gartling, sixteen and two-thirds, ($16\frac{2}{3}$), per centum thereof:

To William Croft, sixteen and two-thirds ($16\frac{2}{3}$), per centum thereof:

To Dorothy J. West, sixteen and two-thirds ($16\frac{2}{3}$), per centum thereof.

That in the event any of said partners at any time desire to sell or otherwise dispose of his, or her, interest in said partnership, he or she shall and hereby does give the other partners a first option for the purchase thereof at a price not less than the book value of said interest as shown by the books of account of said firm; said option shall continue in force and effect for a period of ten (10) days after notice in writing served on each other partner or by U. S. Registered Mail addressed to them at their last known residence address, of said partner's proposed withdrawal from said firm; and in the event any partner shall dispose of his, or her, interest to the other partners or any of them, said business shall be carried on by the remaining partners and said profits and losses, shall be shared by said remaining partners, as their interests appear.

Said partnership shall be continued under the fictitious firm name of "California Well Tool & Machine Works."

That in the event of dissolution of said partnership, said partners shall make a true and just accounting of said business and profits, each to the other, and the same, and all the holdings, property, fixtures and appurtenances thereof shall be divided to said partners as follows: [25]

To George L. Gartling, fifty (50%) per centum thereof:

To Daniel Gartling, sixteen and two-thirds ($16\frac{2}{3}$) per centum thereof.

To William Croft, sixteen and two-thirds, ($16\frac{2}{3}$), per centum thereof.

To Dorothy J. West, sixteen and two-thirds, ($16\frac{2}{3}$) per centum thereof.

In witness whereof, the parties hereto have set their hands, the day and year first above written.

DANIEL GARTLING

GEORGE L. GARTLING

WILLIAM CROFT

DOROTHY J. WEST

Filed Feb. 10, 1947. [26]

In the United States Circuit Court of Appeals
for the Ninth Circuit

Docket No. 8795

COMMISSIONER OF INTERNAL REVENUE,
Petitioner on Review,

vs.

ESTATE OF DANIEL GARTLING, Deceased,
R. N. WEAVER, Executor,
Respondent on Review.

STATEMENT OF POINTS

Comes now the petitioner on review herein, by his counsel of record, and makes this concise state-

ment of points on which he intends to rely on the review herein, to wit:

The Tax Court of the United States erred:

1. In holding that the gain resulting from the sale by the decedent of two-thirds of his undivided three-sixths interest in and to the property and assets of the partnership is a capital gain, and that, since the holding period was in excess of ten years, only fifty per centum of such gain is taxable under section 117 of the Internal Revenue Code.

2. In failing to uphold the Commissioner's determination that the gain resulting from the sale by the decedent of two-thirds of his undivided three-sixths interest in and to the property and assets of the partnership represents ordinary income includible in taxable income in the full amount.

3. In holding that there is a deficiency in income tax for [27] year 1941 of only \$193.33, and in failing to hold that there is a deficiency of \$2,590.87 as determined by the Commissioner.

4. In holding that a partnership interest is a capital asset.

5. In failing to hold that a purported sale of a partnership interest constitutes a sale by an individual partner of his interest in the assets of the partnership, and that the burden falls upon the taxpayer to establish the nature, character, basis and holding period of the component assets and that his failure to do so requires that the Commissioner's determination be sustained.

6. In failing to hold in the instant case that the assets of the partnership are of a character which, if sold by an individual, would result in ordinary gain or loss.

7. In that its memorandum opinion and decision are contrary to law and the Commissioner's regulations.

/s/ THERON L. CAUDLE, CAR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Petitioner on Review.

Service of a copy of the above statement of points is hereby acknowledged this 8th day of Dec., 1947.

/s/ D. WEBSTER EGAN,
Counsel for Respondent on Review.

Received and filed TCUS Dec. 15, 1947. [28]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF THE RECORD TO BE PRINTED

Comes now the petitioner on review herein, by his counsel of record, and complying with the rules of this Court, pertaining to the designation of the portions of the record to be printed, states that he relies upon the entire record certified by the Clerk

of The Tax Court of the United States, and directs that said record so certified be printed as the record on review.

/s/ THERON L. CAUDLE, CAR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Petitioner on Review.

Consented to:

/s/ D. WEBSTER EGAN,
Counsel for Respondent on Review.

Received and filed TCUS Dec. 15, 1947.

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF CONTENTS OF RECORD
ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause, in connection with the petition for review by the said Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries.
2. Pleadings:
 - (a) Petition
 - (b) Answer

3. Memorandum opinion and decision of the Tax Court.
4. Petition for review.
5. Notices of filing petition for review.
6. Stipulation of facts and exhibits attached thereto.
7. Statement of points.
8. Designation of portions of record to be printed.
9. This designation.

/s/ THERON L. CAUDLE, CAR
Assistant Attorney General.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Petitioner on Review.

Service of a copy of the within designation of contents of record on review is hereby admitted this 8th day of Dec., 1947.

/s/ D. WEBSTER EGAN,
Counsel for Respondent on Review.

Received and filed TCUS Dec. 15, 1947. [31]

The Tax Court of the United States, Washington

Docket No. 8795

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ESTATE OF DANIEL GARTLING, Deceased,
R. N. Weaver, Executor,
Respondent.

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 31, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 29th day of December, 1947.

[Seal] /s/ VICTOR S. MERSCH, EMT
Clerk, the Tax Court of the
United States.

[Endorsed]: No. 11826. United States Circuit Court of Appeals for the Ninth Circuit. Commissioner of Internal Revenue, Petitioner, vs. Estate of Daniel Gartling, Deceased, R. N. Weaver, Executor, Respondent. Transcript of the Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed January 3, 1948.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

No. 11826

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

**ESTATE OF DANIEL GARTLING, DECEASED, R. N. WEAVER,
EXECUTOR, RESPONDENT**

**ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE PETITIONER

THERON LAMAR CAUDLE,

Assistant Attorney General.

LEE A. JACKSON,

HILBERT P. ZABKY,

Special Assistants to the Attorney General.

FILED

JUN 14 1948

PAUL P. O'BRIEN,

CLERK

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In the United States Circuit Court of Appeals for the Ninth Circuit

No. 11826

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF DANIEL GARTLING, DECEASED, R. N. WEAVER,
EXECUTOR, RESPONDENT

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES*

BRIEF FOR THE PETITIONER

OPINION BELOW

The memorandum opinion of the Tax Court (R. 11-13) is not reported.

JURISDICTION

This petition for review (R. 15-16) involves an asserted deficiency of \$2,590.87 in individual income tax for the calendar year 1941. The notice of deficiency (R. 7-9) was mailed to the decedent on May 17, 1945. The decedent filed a petition for review with the Tax Court of the United States on July 23, 1945 (R. 4-9), under the provisions of Section 272 of the Internal Revenue Code. Thereafter, the decedent's executor was substituted as a party. (R. 2-3.) The decision of the Tax Court to the effect that there was

a deficiency in income tax for the year 1941 of only \$193.33, and refusing to sustain the Commissioner's deficiency determination in full, was entered on September 8, 1947. (R. 14.) The case is brought to this Court by a petition for review filed by the Commissioner on November 28, 1947 (R. 15-16), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

QUESTION PRESENTED

The decedent was a member of a partnership, in which he possessed a one-half interest. He sold a portion of his interest in the partnership assets to two other persons, whereupon the purchasers were admitted to membership in a new partnership in accordance with their interests in the property.

Did the Tax Court err in holding that the decedent sold an "interest in a partnership" which, without regard to the nature of the partnership property, was a capital asset and gave rise to capital gain?

STATUTE AND REGULATIONS INVOLVED

The applicable provisions of the statute and regulations involved are set forth in the Appendix, *infra*.

STATEMENT

The facts in this case were stipulated (R. 19-29) and may be summarized as follows:

For many years prior to 1941 the decedent was the owner of a one-half interest in a partnership. The partnership, which was organized in California, was engaged in the manufacture of steel forgings. Its assets consisted chiefly of plant, machinery, inventories, and accounts receivable. (R. 19-20.)

On January 2, 1941, the decedent sold two-thirds of his one-half interest "in and to the property and assets of the said partnership" to Dorothy J. West and William M. Croft. The decedent's tax basis for his interest in the assets sold was \$10,679. He received a total of \$24,000 on the sale, with a resulting net profit of \$13,321. (R. 20.)

Concurrrently with the sale the decedent, his partner, and Dorothy J. West and William M. Croft executed articles of partnership, the new partnership to continue under the same firm name as that used by the preceding firm. (R. 20, 26-29.)

The decedent in his original income tax return for the calendar year 1941 failed to report the sale of any portion of his partnership interest. He later filed an amended return showing a long-term capital gain in the amount of \$5,993.83. (R. 20.) The Commissioner, in the deficiency notice, increased the amount of gain to \$13,321, and ruled that the entire amount represented ordinary income. Before the Tax Court, the taxpayer conceded that the amount of gain determined by the Commissioner was correct, and that the only question was whether it should be taxed as long-term capital gain or as ordinary income. (R. 21.) The Tax Court ruled that the gain was taxable as gain from the sale of a capital asset held for more than 10 years. (R. 11-13.)

STATEMENT OF POINTS TO BE URGED

The points to be urged by the Commissioner (R. 29-31) are, in substance, that the Tax Court erred in holding that the gain realized by the decedent was

taxable as gain derived from the sale of a capital asset held in excess of 10 years, and in failing to hold that the gain was taxable as ordinary income.

SUMMARY OF ARGUMENT

I

The decedent, who had been a member of a partnership, sold a portion of his interest in the firm's assets, whereupon the firm was reconstituted with the purchasers being admitted as additional partners in accordance with the interest in the property which they had acquired from the decedent. The Tax Court held that the decedent sold "an interest in the partnership" which, without regard to the nature of the partnership property, was a capital asset, and that his gain should be taxed as capital gain. The decision, which is based on the assumption that the partnership, rather than the partners, owns the partnership assets, is contrary to the statutory scheme for taxing partners. Since the partners alone are taxed on the profits of the business, and since they are considered as the owners of the assets of the business, there was nothing which the decedent could sell except his interest in the specific partnership assets. Contrary to the Tax Court's conclusion, the decedent's interest in the profits and surplus of the business, i. e., his interest in the partnership, is not "property" which can be a capital asset. It is either represented by past profits which have been reinvested in physical assets, or by anticipated profits which constitute an intangible asset of the firm. No matter how regarded, the decedent possessed no in-

terest which could be disassociated from the assets of the firm. The character of the gain which he realized when he made a sale to the newly admitted partners can only be determined from the nature of the assets sold. Since there was no proof in this case that he sold any capital assets, the Commissioner's determination that his gain was ordinary income should have been sustained by the Tax Court.

II

The holding of this Court in *Stilgenbaur v. United States*, 115 F. 2d 283, is in accord with the Commissioner's principal position. However, the Court there employed some language which would indicate that a partner could sell either his interest in the partnership assets, or his interest in the firm. While we do not believe that this distinction is sound, it will, if accepted, equally require a reversal in this case since the undisputed facts here are that the decedent sold an interest in the partnership assets and not an interest in the partnership. Since it has not been established that the gain was derived from capital assets, the Tax Court was wrong in holding that the gain is to be taxed as capital gain.

ARGUMENT

I

A partner does not possess an interest in the partnership which, regardless of the nature of the partnership property, is a capital asset whose sale to newly admitted partners results in capital gain

The decedent for many years was the owner of a one-half interest in a California partnership. On

January 2, 1941, he sold a one-sixth "interest in and to the property and assets" of the partnership to Dorothy J. West, and a similar interest to William M. Croft, thus retaining a one-sixth interest in such assets for himself. (R. 19-20, 24, 25.) Concurrently, a new partnership agreement was drawn up to govern the new partnership, with Dorothy J. West and William M. Croft admitted as partners, and with the decedent (having a one-sixth interest) and his former partner (having a one-half interest) continuing as partners. (R. 26-29.) The decedent received \$12,000 for his interest in the assets conveyed to each of the new partners, or a total of \$24,000. His basis for his interest in those assets was \$10,679, and his undisputed gain on the sale was \$13,321. (R. 20.) The only issue in the case is whether this gain is to be taxed as gain on the sale of a capital asset because, as the Tax Court held, the decedent sold a "partnership interest," which the Tax Court considers to be a capital asset (R. 11-13), or whether, as the Commissioner contends, because the decedent sold a fractional portion of his interest in the partnership assets, the resulting gain is taxable as ordinary gain except to the extent that the taxpayer is able to show that the gain is attributable to the sale of assets which come within the statutory definition of capital assets.

The decision of the Tax Court to the effect that a partner possesses an interest in the partnership which, by itself, and without regard to the nature of the partnership assets, is a capital asset which can be sold, and whose sale may give rise to a capital

gain or a capital loss, is contrary to the congressional scheme for taxing partners and has given rise to a fundamental misapplication of the statute in this case.

At the outset, it will be noted that the Tax Court (R. 12-13) starts with the assumption that local law respecting partnerships is the ultimate source which controls the determination of what the decedent sold to the incoming partners. While, as will be seen, the Tax Court was altogether mistaken about the California law of partnerships, it is considered important to point out that the federal law relating to the taxation of partners is one to be given a uniform, nationwide application, and that Congress never intended that the incidents of such taxation should vary from state to state, depending upon the peculiarities of local law. See *Burnet v. Harmel*, 287 U. S. 103. Cf. *Commissioner v. Tower*, 327 U. S. 280, 287-288. There is nothing in the statutory pattern which would admit the conclusion that Congress intended that the varying rules of local law respecting partnerships should be the initial and ultimate reference point from which the federal taxing problems are to be orientated.¹

¹ It will be noted that the Tax Court stated (R. 12) that the Commissioner "concedes the law of California is controlling." While the Commissioner's brief below stated that the law of California governed the present case, it is clear from the brief as a whole that this only meant that the law of California, where the Uniform Partnership Act prevails, reflects the same basic theory which underlies the federal statutory pattern for taxing partners, namely, that the partners are the owners of the firm assets and that the firm is not an intervening entity which is the owner of those assets.

Having started with the erroneous view that local law is altogether controlling, the Tax Court compounded its error by assuming that in States where the Uniform Partnership Act has been adopted the partnership, as an entity, owns the partnership assets, and that the individual partners do not. From these invalid premises, the Tax Court arrived at the erroneous conclusion that the sale by a partner to incoming partners of a portion of his interest in the firm assets is not a sale of those assets, but is the sale of something altogether different. We propose to demonstrate why these premises and this conclusion are wrong.

The Uniform Partnership Act may be selected as a general guide for the analysis of the nature of a partner's interest, not because that Act controls the interpretation to be given to the taxing statute (as the Tax Court erroneously assumed), but because it basically codified the theory which was then dominant in the jurisprudence of the several States, a theory which Congress had already adopted in the taxation of partnership gains to the partners. Contrary to the Tax Court's views on this, the Uniform Partnership Act does not express the theory that the partnership is an entity separate and apart from the partners, and that it is the legal owner of the partnership assets; on the contrary, the Uniform Act was drafted on the so-called "aggregate" theory, namely, that the partners, holding by a peculiar type of tenancy described in the Act, are the only legal owners of the partnership property. Indeed, whether the "entity" or the "aggregate" theory of partnerships should have

been adopted was one of the focal points of controversy that attended the drafting of the Uniform Act. At this late date there can be no doubt the the theory described by the Tax Court was the very one rejected, after full consideration, by the conference of Commissioners on Uniform State Laws. See Lewis, *The Uniform Partnership Act*, 24 Yale L. J. 617, 640 (1915), where, after outlining the history of the drafting of the Uniform Partnership Act, the author, who was also the final draftsman, states:

At the conclusion of the discussion, the members of the conference all joined in recommending that the Act be drawn on the common law or aggregate theory, and that the partners be treated as owners of partnership property holding by a special tenancy, which should be called tenancy in partnership. This recommendation, as explained, has been carried out.

See further, Lewis, *The Uniform Partnership Act*, 29 Harv. L. Rev. 158-192, 291-313 (1915-1916), where it is stated by way of summary (p. 296):

* * * the adoption of the Act makes it impossible for a court to hold a partnership a legal person, in view of the definition in Section 6, and the express statement in Section 25, that the partners, and therefore assuredly not a fictitious legal person, are co-owners of partnership property holding as tenants in partnership. The theory on which the Act is drawn may be wrong, but a reading of its provisions will show that the Commissioners have adhered to the aggregate theory, dominant in our partnership cases, and have not adopted the legal-person theory.

Accord: *Helvering v. Smith*, 90 F. 2d 590, 590-591 (C. C. A. 2d). California follows this theory in the interpretation of the provisions of the Uniform Act which has been enacted in that State. *Reed v. Industrial Acc. Comm.*, 10 Cal. 2d 191; *Stilgenbaur v. United States*, 115 F. 2d 283 (C. C. A. 9th); *Jung v. Bowles*, 152 F. 2d 726 (C. C. A. 9th).

A brief review of the provisions of the Uniform Act will demonstrate how it carries through this theory. Section 25 (1) of the Uniform Act (Section 2419 (1), Civil Code of California (Deering, 1937)) states—

A partner is co-owner with his partners of specific partnership property holding as a tenant in partnership.

The incidents of this tenancy in partnership are such that each partner has the right to possess the property for partnership purposes, to have no assignment by the other partners except as all assign their rights, to have the property seized only by partnership creditors, and to continue to possess the property for partnership purposes on the death of any other partner. Section 25 (2) of the Uniform Act (Section 2419 (2), Deering, *supra*). Each partner has the power, as an agent of the other partners, to convey such assets for partnership purposes. Section 9 of the Uniform Act (Section 2403, Deering, *supra*). Each partner also has the right, on dissolution, to have the specific partnership property dedicated to partnership debts and the surplus applied to paying the amounts owing to the respective partners. Sec-

tion 38 of the Uniform Act (Section 2432, Deering, *supra*).

While the incidents of this tenancy in partnership differ from those that attended the more ancient forms of common ownership developed by the common law, it is clear that under the Uniform Act the partners, and they alone, are the owners of the partnership property.

The aggregate theory of partnerships which was dominant in the common law before the drafting of the Uniform Act, and which was reflected in the basic provisions of the Uniform Act, expresses the hypothesis on which Congress has generally acted with respect to the taxation of the members of a partnership. See Rabkin and Johnson, *The Partnership under the Federal Taxing Laws*, 55 Harv. L. Rev. 909 (1942).

The starting point for ascertaining the federal taxing pattern is Section 3797 (a) (2) of the Internal Revenue Code (Appendix, *infra*) which contains the following definition:²

The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

² The same definition has existed ever since the adoption of Section 1111 (a) (3) of the Revenue Act of 1932, c. 209, 47 Stat. 169.

Thus, it is readily apparent that the taxing statute is not concerned with anything peculiar to partnerships under local law, but treat alike other kinds of business organizations which possess a unifying thread, namely, common ownership of the business assets by the persons who comprise the organization. This theme runs throughout the provision of the Code relating to the taxation of the partnership gains to the partners. The partnership, as thus defined, is not a taxable entity as a corporation is; instead, only the individual partners are liable to be taxed in their individual capacities for the partnership earnings. Section 181 of the Internal Revenue Code (Appendix, *infra*).³ The partners, moreover, are taxable on their distributive shares of the partnership income, regardless of whether the profits are actually distributed. Section 182 of the Internal Revenue Code (Appendix, *infra*).⁴ The taxing statute has thus not only treated the partners as having realized gain on a disposition of partnership assets exactly as would be true if they were the common owners of those assets, but it has also completely disregarded the fact that under the partnership agreement, or under local law, the partners might not be able to reap the profits at that time. Undistributed profits, to the extent reinvested, merely represent additional property acquired by the part-

³ This has, with one exception, been true ever since Section II D of the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166. The tax on excess profits imposed by the Act of March 3, 1917, c. 156, 39 Stat. 1000, was imposed on partnerships as well as on corporations by Section 201 of that Act.

⁴ With the exception noted in the preceding footnote, this has also been true ever since the adoption of the 1913 Act.

ners and a possible source of future profits. Further, the character of the partnership income (whether capital gain or ordinary income) retains its identity and is taxable to the partners in the same manner as though they had individually sold assets possessing a common ownership. Sections 182 and 183 (a) and (b), Internal Revenue Code (Appendix, *infra*). Again, charitable contributions made by the partnership are allowable as deductions to the individual partners only to the extent that their distributive shares of the donations would be allowable to them as individuals. Section 183 (c), Internal Revenue Code (Appendix, *infra*). Also, the benefit of a deduction for the partnership's net operating losses in the form of a carry-back or carry-over is not allowed to the partnership, but only to the individual partners. Section 189, Internal Revenue Code (Appendix, *infra*).

Further evidence that the taxing statute regards the ownership of partnership assets as being only that of the partners is to be found in the fact that no gain or loss is realized when appreciated or depreciated property is contributed in kind by a partner to the firm, or when such property is distributed in kind by the firm to the partners. Ever since Article 1570, Treasury Regulations 45, promulgated under the Revenue Act of 1918, the Treasury Regulations have explicitly stated that when the partnership dissolves and the firm assets are distributed in kind, no gain or loss is realized by the partners until they dispose of the assets. See Section 19.113 (a) (13)-1, Treasury Regulations 103 (Appendix, *infra*). It has also

been the rule that no gain or loss is realized by a partner when he contributes assets to the partnership which have appreciated or depreciated in value in his hands. See Sol. Op. 42, 3 Cum. Bull. 61 (1920), interpreting the Revenue Act of 1916; G. C. M. 10092, XI-1 Cum. Bull. 114 (1932). These views were specifically enacted in statutory form by the adoption of Section 113 (a) (13) of the Revenue Act of 1934, c. 277, 48 Stat. 680, which bears the same section number in the Internal Revenue Code (Appendix, *infra*). It is important to note that, in adopting this provision of the 1934 Act, Congress merely viewed it as declaratory of existing law.⁵

⁵ H. Rep. No. 704, 73d Cong., 2d Sess., P. 18 (1939-1 Cum. Bull. (Part 2), 554, 567-568). The House Committee on Ways and Means, with reference to this provision, stated:

"The committee also proposes two important changes in connection with the basis provisions, for the purpose of making it entirely certain that there can be no use of the partnership as a medium of tax avoidance in cases of sales of property which has appreciated in value. The result of the provisions of section 113 (a) 13 is that if property is purchased by a partnership the basis of such property to the partnership shall be its cost; but if the property is paid in by a partner then the basis to the partnership shall be the cost or other basis to the partner. The committee believes that this provision simply makes specific the correct interpretation of the general provisions of the present law. Paragraph (13) further provides that if property is distributed in kind by a partnership to a partner, the basis to the partner shall be a proper proportionate part of the cost or other basis to him of his interest in the partnership. An example will make the operation of this proposal clear. Suppose that a partner, A, paid \$10,000 for his interest in a partnership. Suppose that the partnership distributes to the partners property in kind representing one-half of its assets. Irrespective of the value of this property at the time of its distribution, the basis to A of the property distributed to him will be \$5,000, and he will be taxed on any amount for which he thereafter disposes of

In certain limited respects the statute employs the partnership as a unity for accounting purposes. Thus, the partnership, in filing its informational return under Section 187 of the Internal Revenue Code (Appendix, *infra*), may compute the partnership income on a different fiscal basis than that employed by the individual partners in reporting their own income. See Section 188 of the Internal Revenue Code (Appendix, *infra*). Also, the partnership may compute its income by use of either the cash or the accrual method of accounting, without regard to the method of accounting employed by the individual partners. See Rabkin and Johnson, *supra*, p. 912. However, except as Congress has specifically recognized the business association as a unit, it has uniformly taxed the partners as being the common owners of the business assets. See *Neuberger v. Commissioner*, 311 U. S. 83. When Congress has seen fit to make such a departure, it was recognized that this was a deviation from the aggregate theory which has always shaped the basic statutory pattern. Thus, during the period of 1933 to 1937 Congress

the property in excess of \$5,000. The committee believes that this provision embodies merely the correct interpretation of the present law but it appears desirable to have an express statement of the rule in the statute."

See also S. Rep. No. 558, 73d Cong., 2d Sess., pp. 18-19 (1939-1 Cum. Bull. (Part 2) 586, 600-601). To the extent that a contrary rule was reached for taxable years prior to the adoption of the amendment, in *Helvering v. Archibald*, 70 F. 2d 720 (C. C. A. 2d), certiorari denied, 293 U. S. 594; *Helvering v. Walbridge*, 70 F. 2d 683 (C. C. A. 2d), certiorari denied, 293 U. S. 594; and *United States v. Flannery*, 106 F. 2d 315 (C. C. A. 4th), it is clear that those decisions were contrary to Congress' concept of the statute.

prevented the partners from deducting against individual capital gains the partnership capital losses which were in excess of partnership capital gains by more than \$2,000. *Commissioner v. Lamont*, 156 F. 2d 800 (C. C. A. 2d), certiorari denied, 329 U. S. 782. See *Neuberger v. Commissioner*, *supra*, for the contrary rule which had prevailed before 1933. This was deemed to be an exception to the general statutory pattern for when Congress, in the 1938 Act, again permitted the partners to offset against individual capital gains their distributive shares of the partnership long term capital losses, it was recognized that the rule during the preceding period had been a departure from the prevailing statutory scheme. See H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 42-43 (1939-1 Cum. Bull. (Part 2) 728, 758-759).

We submit, accordingly, that there is no foundation for the Tax Court's conclusion that Congress has treated a partnership, like a corporation, as being the owner of the business assets.⁶ On the contrary, we believe it manifest that the taxing statute generally regards the partners, and they alone, as the owners of the firm assets, and that the taxation of

⁶ The views of the Tax Court in the present case concerning the ownership of partnership property may be contrasted with those set forth in *Crawford v. Commissioner*, 39 B. T. A. 521, where, in holding that there is no gain or loss on a proportionate distribution of partnership assets in kind to the partners, it was said (p. 524):

"An ordinary partnership, such as we have here, has no entity in the sense that it may own property separate and apart from the ownership thereof of its members. The members, at all times, own the partnership business and the assets employed in it, and are, therefore, never separated from title thereto."

gain on the sale of those assets has always been considered as being the gain, proportionately, of the partners who own those assets.

When the basic matter of the proper ownership of partnership assets under the taxing statute has been correctly settled, the precise issue of this case is brought into focus more sharply. The question that must be answered is: Does a partner, in addition to his ownership rights with respect to the partnership assets, possess a "property" right in relationship to the firm which, by itself, can constitute an incidence of gain or loss and which is the kind of "property" which Section 117 (a) (1) of the Internal Revenue Code (Appendix, *infra*) defines as a "capital asset"? It is the Commissioner's position that this question must be answered in the negative.

If a partner does possess something (in addition to his ownership of partnership property) which the taxing statute regards as "property" which is capable of being a capital asset, it becomes pertinent to inquire what the nature of this may be. We may again refer to the Uniform Act, not because it controls the tax question but because it demonstrates the source of the Tax Court's ultimate error. Section 24 of the Uniform Act (Section 2418, Deering, *supra*) provides:

The property rights of a partner are (1) his rights in specific partnership property, (2) his interest in the partnership, and (3) his right to participate in the management.

Section 26 of the Uniform Act (Section 2420, Deering *supra*) further defines the partner's "interest in the partnership" as being "his share of the profits and surplus" and states that this is to be personal property. Totally oblivious of the partner's rights in specific partnership property, the Tax Court seizes on the partner's interest in the "profits and surplus" of the firm and declares this to be the "property" which constitutes a capital asset under Section 117 (a) (1) of the Internal Revenue Code.

In the context of the Uniform Act, a partner's interest in the partnership (i. e., in the firm's profits and surplus) performs a very important function for it permits a partner to assign his interest in the firm without the assent of his partners, thus entitling his assignee to receive the assignor's share of future profits; the assignment, however, does not dissolve the partnership, it does not make the assignee a partner, and it does not make him a co-owner with the other partners of the specific partnership assets. Section 27 of the Uniform Act (Section 2421, Deering, *supra*). The purpose of this section was to clarify what had been a source of great confusion in the state of the law as it had developed prior to the codification. See: Commissioners' Notes to Sections 25 and 26, 7 Uniform Laws Annotated (1922); Lewis, *supra*, 24 Yale L. J. 617, 626.

Although, as we shall show, a partner's interest in the firm does not possess an equal significance in the taxing statute and cannot itself be a source of gain or loss, we believe it significant that the present case is not at all one of an assignment of a partner's "in-

terest in the partnership" which would merely have entitled the assignees to receive the assignor's share of the profits. Here, rather, with the assent of the decedent's partner, there was a dissolution of the old partnership and the formation of a new firm with the decedent's transferees admitted as partners. *Ellingson v. Walsh, O'Connor & Barneson*, 15 Cal. 2d 673, 676. The incoming partners in this case are entitled to share in the firm's future profits, not because the decedent transferred his interest in the firm without his co-partner's consent, but rather because he sold his interest in the specific partnership assets, as he was entitled to do with his partner's assent, and because his transferees, with the consent of all, contributed that interest to the formation of the new firm. They share the new firm's profits because they are partners, and not as assignees of an interest in the old firm. Since the only thing that the decedent could have sold in the context of the present case, as would be true of any similar situation, was his interest in the specific assets of the firm as they existed at the time of dissolution, those assets were the only source of his admitted gain. If local law be emphasized, those assets are the only factors which can determine the nature of the gain, namely, whether it be ordinary gain or capital gain under Section 117 (a) (1) of the Internal Revenue Code.

Returning to a consideration of the tax statute, it will be seen why, without regard to the mechanics of local partnership law, an interest in the firm's profits and surplus cannot be the source of gain and cannot be the "property" referred to in Section 117

(a) (1). Bearing in mind that a partner, as long as he remains a partner, is taxed on his annual share of the partnership profits without regard to whether those profits are withdrawn from the business, it is self-evident that a partner's interest in past profits, as such, cannot be the subject matter on which further taxable gain or loss can be sustained. That is so whether the sale be to the remaining partners, to incoming partners, or to third persons. To the extent that profits previously earned and taxed have been withdrawn from the business, there can clearly be no further loss or gain on those profits. To the extent that past profits have been permitted to remain in the business, they will be represented either by cash or by other physical assets which have been purchased with those profits. It seems self-evident that a transfer of past-profits at a taxable gain or loss would be meaningless—the only thing that could be sold at a taxable gain or loss would be the property in which those profits have been invested.

Accordingly, when a partner sells a portion of his so-called interest in a partnership at a profit, what is sold must be related to the then existing partnership property. Where, as here, there is a taxable gain on the sale, it is explicable for one or a combination of several reasons. (1) Partnership property may have appreciated in value after the time when it was acquired by the firm. Where this is the case, the incoming partner will normally pay for his proportionate share of the then existing value of the firm assets. He will not be concerned with and his payment will obviously have no relationship

to the tax basis of the selling partner. In such an event, the selling partner's disposition of a portion of his interest in the firm's appreciated assets for cash should be the occasion for taxing gain since he has realized some part or all of the appreciation at that time. (2) There may have been no appreciation in value while the assets were held by the firm, but there may have been a prior appreciation in value in the partner's hands, but which was not realized earlier because contributed by the partner to the firm. See Section 113 (a) (13), Internal Revenue Code. In such a situation, too, the value of the assets at the time that the incoming partner purchases his interest may be determinative of what is paid, and it will have no relationship to the selling partner's tax basis. Again, since the selling partner has realized the increment in value which was not previously taxed, the gain becomes taxable at the time of the sale. (3) The tax basis of the property may differ from its physical value at the time of the sale because prior allowable or allowed deductions for depreciation have been greater than the actual physical depreciation. In this case, as frequently occurs with respect to any business property, the previous reductions in tax basis afforded because of the prior deductions for depreciation require that the gain be taxed when the sale is made. In all these instances, the character of the gain must relate to the type of property which has been the source of the profit. If it was a capital asset, the gain should be taxed as capital gain; if it was a non-capital asset, the gain should be taxed as ordinary income.

The question arises whether a partner may not sell his interest in the future profit making ability of the firm, and whether, when an incoming partner is willing to pay more than is represented by his proportionate share of the physical assets, there is not a sale of an interest in such future profits which, not being directly associated with the existing physical assets of the firm, can constitute a property right which, itself, ^{is} capable of being a capital asset. In a proper situation where future profit making ability of a business enterprise is capable of being evaluated, it would constitute an intangible asset of the partnership, expressed in terms of "good-will." Where the selling partner disposes of all or a portion of his interest in the good-will of the firm, this would constitute a sale of one of the partnership assets just as would be true of the sale of any of the physical assets. Where this is the source of gain to the selling partner, it may constitute the sale of a capital asset and a resulting capital gain. The total gain derived by the selling partner, however, may be only partly attributable to good-will, with the rest derived from the sale of other partnership assets. It is certainly erroneous, in any situation, to lump the whole gain together and classify it as capital gain. The only correct procedure is to examine the source of the gain and to determine its nature from the type of asset sold.

It should be emphasized that the present case does not involve the sale of any good-will. None appeared on the partnership books, and the taxpayer has never claimed or proved that future profit making ability

of the partnership accounted for any portion of the gain which was realized by the decedent.

Because a partner, unlike a stockholder, is treated by the taxing statute as a co-owner of the business assets who is taxable on the partnership profits, and because the partnership, unlike a corporation, is not a taxable business entity, it must be concluded that Congress never envisaged a partner as possessing a right in the business which can be disassociated from the business assets and which, by itself, can be considered "property" that can fulfill the definition of a capital asset. Instead, a person who is associated with others in conducting a partnership business differs from an individual who conducts a business as a sole proprietorship only in the respect that the former is a co-owner, holding by a tenancy in partnership, of the business assets, while the latter is the sole owner. Where an individual proprietor sells his business as a going concern, or an interest in it, each asset sold must be examined to determine its nature. *Williams v. McGowan*, 152 F. 2d 570 (C. C. A. 2d). Similarly, where a partner sells all or part of his interest in the firm assets, the character of any gain can only be ascertained by an examination of the items of property which have been sold.

Where items of partnership property are sold in the ordinary course of the partnership business, it is clear that the partners are to be taxed in accordance with the nature of the items of property sold. Sections 182 and 183, Internal Revenue Code (Appendix, *infra*). When an interest in those assets is trans-

ferred to an incoming partner, there is nothing in the statute to indicate that Congress intended a different result, or that it ever envisaged that items of property which would give rise to ordinary income when sold in the ordinary course of business, become transformed in character upon a sale to an incoming partner, and that the sale of ordinary assets in those circumstances should emerge as capital gain. See *Helvering v. Smith*, 90 F. 2d 590 (C. C. A. 2d), holding that a lump sum payment by the continuing partner to a retiring partner is taxable as ordinary income to the recipient, there being no capital assets in the firm which could have been the subject matter of a sale, and *Doyle v. Commissioner*, 102 F. 2d 86 (C. C. A. 4th), where it was held that a retiring partner who received a stipulated amount from his former partner on account of a disputed legal fee which had not yet been collected, was taxable as having received ordinary income.

A further, and conclusive reason which demonstrates the invalidity of the Tax Court's conclusion lies in the fact that it creates differences where none were ever intended by Congress. Considering a partner's interest in the partnership earnings and surplus as capable of being sold as a capital asset, the Tax Court reaches a result which is *sui generis* with respect to partnerships. Yet, as we have seen, Congress, by Section 3797 (a) (2) of the Internal Revenue Code, has plainly legislated on the supposition that all of the business organizations there defined as partnerships are to be taxed exactly the same, and that a business organization which qualifies

as a partnership under local law is to be considered no different than the other organizations there defined. In the other types of organizations where the members are taxed as partners, it would seem undeniable that upon the admission of a new member the selling member would have nothing to sell except his common interest in the business assets, and that his interest in the business could not, of itself, constitute a capital asset. We submit that Congress did not intend that a member of an organization which happens to qualify as a partnership under local law should be given different tax results than those which would obtain in the case of the members of any other organization which Congress has also defined as a partnership.

The decisions on this point are in an unsatisfactory state. In *City Bank Farmers Trust Co. v. United States*, 47 F. Supp. 98, where there was a sale of a partner's interest and the partnership property was composed of capital assets, the Court of Claims held that the holding period for determining the taxable amount of capital gain must be related to the time that each specific partnership asset had been held. This view is in accord with the basic principles expressed herein, as are the decisions in *Helvering v. Smith*, *supra*, and *Doyle v. Commissioner*, *supra*. It is opposed, however, by *Thornley v. Commissioner*, 147 F. 2d 416 (C. C. A. 3d),⁷ and *Commissioner v. Lehman*, 165 F. 2d 383 (C. C. A. 2d), certiorari denied, May 17, 1948, both of which decided that the

⁷ See also *Kessler v. United States*, 124 F. 2d 152 (C. C. A. 3d).

holding period relates to the time that the selling partner was a partner. In *Commissioner v. Shapiro*, 125 F. 2d 532 (C. C. A. 6th), it was held that gain realized by a partner on retirement was taxable as capital gain. It appears from the opinion in that case that some of the assets owned by the partnership were non-capital in nature, but there is nothing to indicate whether the gain represented previously unrealized appreciation of such assets. On the other hand, the partnership possessed good-will and, perhaps, other intangibles which would have been capital assets and a possible source of the capital gain.⁸ Rabkin and Johnson, *supra*, say of this case (fn. 40, p. 927):

The holding may be reconciled with the other cases on the hypothesis that "going value" or "good will" is itself a capital asset.

In *McClellan v. Commissioner*, 117 F. 2d 988 (C. C. A. 2d), affirming 42 B. T. A. 124, and *Munson v. Commissioner*, 100 F. 2d 363 (C. C. A. 2d), the holding that the retiring partner had sold a capital asset can be explained on the ground that the partnership assets (stock exchange seats) which occasioned the loss in the *McClellan* case and the gain in the *Munson* case were, themselves, capital assets. The position of the Tax Court in this and similar cases,⁹ which is

⁸ The bill of sale in the *Shapiro* case, p. 534, included "good-will, copyrights, formulae, trade name, book accounts, mailing lists, machinery and equipment."

⁹ *Long v. Commissioner* decided March 29, 1947 (1947 P. H. T. C. Memorandum Decisions Service, par. 47, 155), pending on cross petitions for review in the Circuit Court of Appeals for the Fifth Circuit; *Smith v. Commissioner*, 10 T. C. No. 49; and *Humphrey v.*

founded on the notion that the partnership, and not the partners, owns the firm assets, may be contrasted with the opposing view which it expressed in *Crawford v. Commissioner, supra*. This Court's decision in *Stilgenbaur v. United States, supra*, which takes an intermediate position on the matter, will be discussed under Point II, *infra*.

II

If relevant, the undisputed facts in this case show that the decedent sold an interest in specific partnership assets and did not sell an interest in the partnership

We believe that the analysis under Point I, *supra*, is sound and embodies the correct solution to the type of problem which is raised by this kind of case. Accordingly, we submit that it was error for the Tax Court to hold that the decedent had sold a capital asset. Absent any proof that the gain was attributable to capital assets sold to the incoming partners, the Tax Court should have sustained the Commissioner's deficiency determination which found that no capital gain had been realized.

In *Stilgenbaur v. United States, supra*, this Court held that the retiring partner there had sold to the continuing partners his interest in the specific partnership property; it was held that the loss was a capital loss because those assets were capital assets. The decision in the *Stilgenbaur* case is fully in accord with the result which the Commissioner contends

Commissioner, 32 B. T. A. 280 (nonacquiescence XIV-2, Cum. Bull. 34 (1935)). See also *Whitney v. Commissioner*, 8 T. C. 1019, pending on cross petitions for review in the Circuit Court of Appeals for the Second Circuit.

should apply in this case, namely, that the gain is taxable as capital gain only to the extent that the assets sold are capital assets, and that it is ordinary income to the extent that they are noncapital assets.

There is, however, some *dicta* in the *Stilgenbaur* case which would seem to envisage a partner as selling his "partnership interest" where he so intends. That is, the decision holds that where a selling partner states that he is selling his interest in the firm's assets, the nature of the gain is controlled by the nature of those assets. However, the decision intimates that if he declares that he is selling his "partnership interest," this might be the sale of a capital asset, although it is not clear whether this was intended to imply that such a sale would always be that of a capital asset. If that was the intent of the *dicta*, we submit, in the light of the analysis under Point I, *supra*, that the indicated result would be erroneous. We firmly believe that the tax consequences ought not depend upon the words employed; since the effect of the transfer, whether denominated as a sale of a partnership interest or as a sale of an interest in partnership assets, is precisely the same, the application of the taxing statute ought to be the same, uninfluenced by the choice of language in the instrument of transfer. If the transferor sells an interest in non-capital assets to the incoming partners, he ought not to receive the benefit of the tax on capital gains merely because the bill of sale refers to a "partnership interest" as having been sold and does not speak in terms of the interest in the partnership assets which is actually being conveyed.

If this Court, however, should decide to adopt the *dicta* of the *Stilgenbaur* case, and should hold that the issue turns on the nature of the language employed, it should be observed the Tax Court's decision on the facts of this case would be contrary to this position. The undisputed facts in this case show that the bills of sale each recited that the decedent had sold (R. 24, 25) "an undivided one-sixth ($\frac{1}{6}$), interest in and to the property and assets" of the partnership. The new articles of the partnership agreement also recited that the decedent had sold to the incoming partners (R. 26) "two-sixths' of said mentioned undivided interest in and to the property and assets of said partnership." Also, the stipulation refers only to a sale of a portion of the decedent's interest (R. 20) "in and to the property and assets of the said partnership." Nowhere is there any mention of a sale of a "partnership interest." Accordingly, if under the *Stilgenbaur* case a distinction is to be drawn between the sale of a partnership interest and the sale of an interest in partnership assets, it is clear that the decedent here sold an interest in partnership assets and not in the partnership. The decision of the Tax Court, in holding to the contrary, is contrary to the evidence.¹⁰ Since it was stipulated (R. 19-20) that the assets of the partner-

¹⁰ The Tax Court's decision contravenes the evidence in another respect. The stipulation (R. 20) only establishes the decedent's tax basis for the interest in the partnership assets which he sold. There is no evidence of his basis for the so-called "partnership interest", if any exists and was sold. The Tax Court, unsupported by any evidence, assumed (R. 12) that the basis for the "partnership interest" was the same as the basis for the partnership assets.

ship “consisted chiefly of the plant, machinery, inventories and accounts receivable”, and since these items would be excluded from the definition of a capital asset under Section 117 (a) (1), because constituting stock in trade, or property properly included in inventory, or property subject to depreciation, the Tax Court was wrong in deciding that the gain was capital gain. At all events, if the gain was derived from capital assets, it was for the taxpayer to prove this. Since no such proof was made, the Commissioner’s determination that the gain was ordinary income should have been sustained by the Tax Court.

CONCLUSION

In view of the foregoing, the decision of the Tax Court should be reversed.

Respectfully submitted.

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JUNE 1948.

APPENDIX

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(13) *Partnerships.*—If the property was acquired, after February 28, 1913, by a partnership and the basis is not otherwise determined under any other paragraph of this subsection, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. If the property was distributed in kind by a partnership to any partner, the basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

* * * * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or

property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1);

(2) *Short-term capital gain*.—The term “short-term capital gain” means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

* * * * *

(4) *Long-term capital gain*.—The term “long-term capital gain” means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income:

* * * * *

(b) *Percentage taken into account*.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66 $\frac{2}{3}$ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

* * * * *

(26 U. S. C. 1940 ed., Sec. 117.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1940 ed., Sec. 181.)

Sec. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b). (26 U. S. C. 1940 ed., Sec. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) *Segregation of items.*—

(1) *Capital gains and losses.*—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) *Ordinary net income or loss.*—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable contributions.*—In computing the net income of the partnership the so-called “charitable contribution” deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his dis-

tributive portion of any contribution or gift, payment of which was made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted. (26 U. S. C. 1940 ed., Sec. 183.)

SEC. 184. CREDITS AGAINST NET INCOME.

The partner shall, for the purpose of the normal tax, be allowed as a credit against his net income, in addition to the credits allowed to him under section 25, his proportionate share of such amounts (not in excess of the net income of the partnership) of interest specified in section 25 (a) as are received by the partnership. (26 U. S. C. 1940 ed., Sec. 184.)

SEC. 185. EARNED INCOME.

In the case of the members of a partnership the proper part of each share of the net income which consists of earned income shall be determined under rules and regulations to be prescribed by the Commissioner with the approval of the Secretary and shall be separately shown in the return of the partnership. (26 U. S. C. 1940 ed., Sec. 185.)

SEC. 186. TAXES OF FOREIGN COUNTRIES AND POSSESSIONS OF UNITED STATES.

The amount of income, war-profits, and excess-profits taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of the member of a partnership to the extent provided in Section 131. (26 U. S. C. 1940 ed., Sec. 186.)

SEC. 187. PARTNERSHIP RETURNS.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations

prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners. (26 U. S. C. 1940 ed., Sec. 187.)

SEC. 188. DIFFERENT TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

If the taxable year of a partner is different from that of the partnership, the inclusions with respect to the net income of the partnership, in computing the net income of the partner for his taxable year, shall be based upon the net income of the partnership for any taxable year of the partnership (whether beginning on, before, or after January 1, 1939) ending within or with the taxable year of the partner. (26 U. S. C. 1940 ed., Sec. 188.)

SEC. 189 (as added by Section 211 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862) NET OPERATING LOSSES.

The benefit of the deduction for net operating losses allowed by section 23 (s) shall not be allowed to a partnership but shall be allowed to the members of the partnership under regulations prescribed by the Commissioner with the approval of the Secretary. (26 U. S. C. 1940 ed., Sec. 189.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and partner.*—The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in

such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.113 (a) (13)-1. *Property contributed in kind by a partner to a partnership.*—The basis of property contributed in kind by a partner to partnership capital after February 28, 1913, is the cost or other basis thereof to the contributing partner. Annual allowances to the partnership for depletion and depreciation are to be computed on such basis. If such basis is greater than the fair market value of the property at the date of the transfer to the partnership, the annual depletion or depreciation allowances shall be allocated to and included in the determination of the distributive shares of the partners in accordance with their agreement in respect of the sharing of gains or losses affecting partnership capital. If the basis of such contributed property is less than the fair market value thereof at the date of transfer to the partnership, the annual allowances for depletion and depreciation are to be limited to such basis and may be apportioned among the partners according to their agreement with respect to the sharing of gains or losses affecting partnership capital. On the sale or other disposition of such contributed property by the partnership the gain or loss, determined on such transferred basis, adjusted as required by section 113 (b), shall be prorated in determining the distributive shares of the partners according to their gain or loss ratios on the disposition of a partnership asset under the partnership agreement.

SEC. 19.113 (a) (13)-2. *Readjustment of partnership interests.*—When a partner retires from a partnership, or the partnership is dis-

solved, the partner realizes a gain or loss measured by the difference between the price received for his interest and the sum of the adjusted cost or other basis to him of his interest in the partnership plus the amount of his share in any undistributed partnership net income earned since he became a partner on which the income tax has been paid. However, if such interest in the partnership was acquired prior to March 1, 1913, both the cost or other basis as hereinbefore provided and the value of such interest as of such date, plus the amount of his share in any undistributed partnership net income earned since February 28, 1913, on which the income tax has been paid, shall be ascertained, and the gain derived or the loss sustained shall be computed as provided in section 19.111-1. See also section 117. If the partnership distributes its assets in kind and not in cash, the partner realizes no gain or loss until he disposes of the property received in liquidation. The basis of such property in the hands of the partner shall be such part of the basis in his hands of his partnership interest as is properly allocable to such property.

If a new partner is admitted to the partnership, or an existing partnership is reorganized, the facts as to such change or reorganization should be fully set forth in the next return of income, in order that the Commissioner may determine whether any gain has been realized or loss sustained by any partner.



In the
United States
Circuit Court of Appeals
For the Ninth Circuit

No. 11827

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Corpus of DONALD E. McDONALD,

Petitioner and Appellant,

v.

TOM SMITH, Superintendent of the Washington State
Penitentiary at Walla Walla, Washington,

Respondent and Appellee.

APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE EASTERN DISTRICT OF
WASHINGTON, SOUTHERN DIVISION

HONORABLE SAM M. DRIVER, JUDGE

BRIEF OF APPELLEE, TOM SMITH

Superintendent of the Washington State Penitentiary at
Walla Walla, Washington

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Superintendent of the Washington State Penitentiary at
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COUNTERSTATEMENT OF THE CASE

This matter is before the court on appeal from an
order entered by the Honorable Sam M. Driver, as a
judge of the United States District Court for the Eastern

District of Washington, Southern Division, denying appellant's application to be permitted to file *in forma pauperis* a petition for writ of habeas corpus. The order, with the formal parts omitted, is as follows (Tr. 15):

"This matter is before the Court on motion and affidavit of the above named petitioner for permission to file a petition for writ of habeas corpus in forma pauperis, and upon the reading and consideration of said petition, it appearing to the Court that the petitioner has not exhausted his legal remedies in the Courts of the State of Washington, and that this Court is without jurisdiction to entertain said petition,

"IT IS, THEREFORE, ORDERED AND ADJUDGED that the application to be permitted to file said petition for writ of habeas corpus in forma pauperis is hereby denied.

"DATED this 6th day of November, 1947."

The petition alleges that the judgment and sentence, pursuant to which the appellant is being detained, is defective in that (1) it is not complete on its face, (2) the crime of which the petitioner was convicted is not sufficiently described therein, and (3) only a maximum term is fixed when the statute provides that the penalty for the crime charged shall be for a term of "not less than one year nor more than ten years." (Sec. 16, chapter 172, Laws of 1935; Rem. Rev. Stat. Supp. 2516-16.) (Tr. 4.)

It further recites that a petition for habeas corpus was filed in the Supreme Court of the State of Washington, which court issued a show cause order setting the case for hearing before the Superior Court of Spokane County, Washington (Tr. 4, 5). As shown in the petition, the Superior Court of Spokane County denied the appli-

cation for a writ (Tr. 5) on May 26, 1947 (Tr. 12). The application to the state court was made prior to the effective date of Chapter 256, Laws of 1947, which greatly broaden the scope of habeas corpus in the State of Washington.

There is no indication in the present petition that the appellant availed himself of remedies in courts of Washington in either of the following ways: (1) by perfecting an appeal from the decision of the Spokane County Superior Court or (2) by applying for habeas corpus under Chapter 256, Laws of 1947.

The Federal District Court denied the present petition without a hearing because it indicates on its face "that the petitioner has not exhausted his legal remedies in the Courts of the State of Washington."

ARGUMENT

Throughout his argument, the appellant assumes that he has exhausted his state remedies, failure to show which was the basis for the order of the District Court. It is apparent from the petition for a writ of habeas corpus that no appeal was taken from the order of the Spokane County Superior Court denying an application for habeas corpus, nor has any petition for a writ of habeas corpus been submitted to the state courts since the effective date of Chapter 256, Laws of 1947 (Washington) which radically changes the scope of inquiry on application for the writ in the state courts. And there is no showing that he has attempted to present the Federal

question allegedly in his case, to the United States Supreme Court on appeal or certiorari from the state court.

It is incumbent upon one serving a sentence imposed by a state court to exhaust the remedies available to him under the law of the state before he is entitled to seek a writ of habeas corpus in the Federal courts. *Ex Parte Hawke*, 321 U. S. 114, 116-117, 64 S. Ct. 448, 88 L. Ed. 572; *Barton v. Smith*, 9 Cir., 162 F. (2d) 330, 331; *United States v. Ragen*, 7 Cir., 153 F. (2d) 600; *United States v. House*, 9 Cir., 110 F. (2d) 797; *Herzog v. Colpoys*, 79 U. S. App. D. C. 81, 143 F. (2d) 137.

In exceptional cases requiring prompt action, a Federal court may interfere by habeas corpus before remedies available in the state courts have been exhausted. *Urquhart v. Brown*, 205 U. S. 179, 182, 27 S. Ct. 459, 51 L. Ed. 760. However, the petition now under consideration is not based upon urgency, and does not qualify as being an exception to the regular rule.

The law requiring persons serving sentences imposed by state courts to exhaust legal remedies available in the courts of the sentencing state before seeking a writ of habeas corpus in the Federal courts is so well settled that the present petition could have been summarily denied. However, the order merely denied leave to file the petition without payment of fees. Manifestly, the order entered is correct as the appellant's petition did not make a prima facie showing of right to relief.

In *Johnson v. Hunter*, 10 Cir., 144 F. (2d) 565, the court denied leave to appeal in *forma pauperis* because

the petition for a writ of habeas corpus failed to disclose that the petitioner has a meritorious cause. The following language from that opinion expresses the view which is proper in this case:

"The burden is upon the indigent litigant to allege facts which, if true, entitle him to relief. He may also be required to make a satisfactory showing that he can produce competent evidence in support of the allegations before he is entitled to proceed without payment of costs and at the expense of the government. Courts are and should be diligent to afford to indigent litigants with a meritorious cause the benefit of the statute. On the other hand, they are fully justified in being diligent in limiting such actions to those in which there is a showing of merit.

"It may be that the petitioner, under the true facts, can file a petition which shows such merit that the trial court will permit him to proceed in forma pauperis. We think the trial court was well within his discretion in denying petitioner the right to proceed in forma pauperis on the petition which he filed. The denial of the appeal herein is without prejudice to the right of petitioner to file another petition." 144 F. (2d) at 567.

CONCLUSION

Since the District Court did not pass upon the merits, we do not believe it necessary to discuss the questions raised in the petition, although the appellant bases his appeal upon the matters relied upon as a basis for issuance of the writ rather than the order from which the appeal is taken.

We submit that the petition fails to demonstrate that the appellant has exhausted the remedies available to him in the courts of the State of Washington and consequently the Federal District Court correctly denied leave to file the petition without payment of fees.

The order of the District Court should be affirmed.

SMITH TROY,
Attorney General,

LUCILE LOMEN,
Assistant Attorney General,

Attorneys for Appellee.

No. 11828

United States
Circuit Court of Appeals
For the Ninth Circuit.

SEATTLE STAR, INC., a Corporation, and E. L.
SKEEL, Liquidating Trustee,

Appellants,

vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington,
Northern Division

FILED

MAR -4 1948

PAUL P. CORBIN,

CLERK

United States
Circuit Court of Appeals
For the Ninth Circuit.

SEATTLE STAR, INC., a Corporation, and E. L.
SKEEL, Liquidating Trustee,

Appellants,

VS.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

Transcript of Record

Upon Appeal from the District Court of the United States
for the Western District of Washington,
Northern Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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Seattle, Washington,

JOHN E. BELCHER,
Assistant United States Attorney,
1017 U. S. Court House,
Seattle, Washington. [1*]

United States District Court, Western District of
Washington, Northern Division

No. 1872

JOHN RANDOLPH and PHILIP W. TAYLOR,
Plaintiffs,

vs.

SEATTLE STAR, INC., a Corporation, and E. L.
SKEEL, Liquidating Trustee,
Defendants.

PETITION FOR ENFORCEMENT OF VET-
ERAN'S RIGHTS UNDER ACT OF SEP-
TEMBER 16, 1940, AS AMENDED, PUBLIC
LAW NO. 783, 76th CONGRESS, TITLE 50
U.S.C. (App.) Sec. 308.

The petitions of John Randolph and Philip W.
Taylor respectfully allege that:

1. This is a petition under Section 8(e) of the
Selective Training and Service Act of 1940 (54
Stat. 890, 50 U.S.C. App. Sec. 308(e) as amended,
and the jurisdiction of this Court is based on that
section.

2. Petitioner John Randolph is a resident of
Seattle, Washington, and resides at 5027 12th
Ave. N.E.

3. Respondent, Seattle Star, Inc., is, and at all
times hereinafter mentioned was, a corporation,
organized and existing under the laws of the State
of Washington, and at the times hereinafter men-

tioned did maintain a place of business in Seattle, Washington, and was the publisher of a daily newspaper known as "Seattle Star."

That said Seattle Star, Inc., is presently going through the process of voluntary dissolution, having filed with the Secretary of State of the State of Washington a petition for voluntary dissolution on the 13th day of August, 1947, and respondent E. L. Skeel is its Liquidating Trustee.

4. Beginning on or about September 24, 1936, and until January 9, 1942, petitioner John Randolph had a position in the employ of respondent Seattle Star, Inc. Said position was not a temporary one. The place at which petitioner performed the duties of said position was [2] Seattle, Washington.

5. Petitioner John Randolph's position was that of reporter with respondent corporation from September 24, 1936, to January 9, 1942.

6. Petitioner John Randolph continued to work for, and to occupy said position in the employ of Seattle Star, Inc., until the 9th day of January, 1942.

7. On or about the 15th day of January, 1942, at Tacoma, Washington, petitioner John Randolph was inducted into the Army of the United States and thereupon entered into military training and service of the United States in said forces.

8. Petitioner John Randolph left his aforesaid position on the 9th day of January, 1942, for the

purpose of entering into the military training and service of the United States, as alleged in paragraph 7 hereof, and performing his training and service therein.

9. Petitioner John Randolph satisfactorily completed his period of training and service in the land forces of the United States on the 10th day of December, 1945, and re-entered the employ of respondent, Seattle Star, Inc., on the 14th day of January, 1946, and continued in said employment continuously until the discontinuance of publication of said Seattle Star on the 13th day of August, 1947, when he was discharged by reason thereof.

10. Petitioner John Randolph is a member in good standing of Seattle Newspaper Guild, Local 82, a local union chartered by American Newspaper Guild, a voluntary association.

11. That on the 1st day of January, 1946, a contract in writing was entered into between Seattle Star, Inc., and Seattle Newspaper Guild, Local 82, on behalf of the employees in the editorial, advertising, business office and circulation departments of said Seattle Star, Inc., by the terms of which it was, in Article X thereof agreed as follows, to-wit:

“An employee who is required by the United States or any subsidiary thereof to enter any kind of service, military or otherwise, which takes him out of the employment of the Publisher, or who, while the United States is at war, voluntarily enters into any of the mili-

tary armed services of the United States, or who is released from his job as a result of any government order or ruling, shall be deemed to be an employee on leave of absence, and shall resume his position or a comparable one within two (2) weeks from date of his notice of desire to resume employment, with [3] dismissal pay rating and other rights under the contract unimpaired * * *,”

which provision was in effect under a former contract at the time petitioner John Randolph entered the military service in 1942. A copy of said contract is attached hereto as Exhibit “A” and made a part hereof.

12. That by Article VIII of said contract, it is further provided:

1. Upon dismissal, an employee shall receive written notice from the Publisher or his agents stating the cause for his dismissal if such written notice is requested by the employee.
2. Upon dismissal, any employee covered by this contract shall receive a cash severance pay in accordance with the following schedule:

Six months and less than one year.....	2 Weeks
One year and less than two years.....	3 ”
Two years and less than two and one-half years	4 ”
Two and one-half years and less than three years	5 ”
Three years and less than three and one-half years	6 ”
Three and one-half years and less than four years	7 ”

Four years and less than four and one-half years	8	''
Four and one-half years and less than five years	9	''
Five years and less than five and one-half years	10	''
Five and one-half years and less than six years	11	''
Six years and less than six and one-half years	12	''
Six and one-half years and less than seven years	13	''
Seven years and less than seven and one-half years	14	''
Seven and one-half years and less than eight years	15	''
Eight years and less than eight and one-half years	16	''
Eight and one-half years and less than nine years	17	''
Nine years and less than nine and one-half years	18	''
Nine and one-half years and less than ten years	19	''
Ten years and less than ten and one-half years	20	''
Ten and one-half years and less than eleven years	21	''
Eleven years and less than eleven and one-half years	22	''
Eleven and one-half and less than twelve years	24	''
Twelve years and less than twelve and one-half years	26	''
Twelve and one-half years and over.....	28	''

13. Petitioner John Randolph satisfactorily completed his period of training and service in the land forces of the United States on the 10th day of December, 1945, and on that date received a certificate of honorable discharge from the Army of the United States, evidencing such satisfactory completion.

14. That petitioner John Randolph was restored to his former position on January 14, 1946, and by virtue of his continuous employment covering a

period of ten years and eleven months (Sept. 24, 1936, to August 13, 1947) became entitled, on August 13, 1947, to receive severance pay under the provisions of the contract referred to, on the date of his dismissal, for the period of 21 weeks, at the rate of \$73.50 per week, or the total sum of One Thousand Five Hundred Forty-three Dollars and Fifty Cents (\$1543.50).

15. Respondents have refused and still refuse to pay petitioner John Randolph severance pay covering the period of his military service, but in lieu thereof have offered respondent severance pay in the amount of Nine Hundred Fifty-five Dollars and Fifty Cents (\$955.50), which sum respondent John Randolph has refused to accept.

16. By virtue of the provisions of Section 308(a) (B), Title 50 App. U.S.C., petitioner John Randolph has not been accorded that protection to which he is entitled to under subsection (c) of Sec. 308, Title 50 App. U.S.C.

And for a second cause of action:

1. Petitioner Philip W. Taylor hereby adopts paragraph 1 of the John Randolph first cause of action and makes the same a part hereof by reference and without repetition. [5]

2. Petitioner Philip W. Taylor is a resident of Seattle, Washington, and resides at Sorrento Hotel.

3. Petitioner Philip W. Taylor hereby adopts paragraph III of the John Randolph, or first cause of action, and makes the same a part hereof by reference and without repetition.

4. Beginning in the month of February, 1942, and until August 20, 1942, petitioner Philip W. Taylor had a position in the employ of respondent, Seattle Star, Inc. Said position was not a temporary one. The place at which petitioner performed the duties of said position was Seattle, Washington.

5. Petitioner Philip W. Taylor's position was that of reporter with respondent corporation from February, 1942, to August 20, 1942.

6. Petitioner Philip W. Taylor continued to work for and occupy said position in the employ of Seattle Star, Inc., until August 20, 1942.

7. On or about August 20, 1942, at Tacoma, Washington, petitioner Philip W. Taylor was inducted into the army of the United States and thereupon entered the military training and service of the United States in said forces.

8. Petitioner Philip W. Taylor left his afore-said position on the 20th day of August, 1942, for the purpose of entering into the military training and service of the United States, as alleged in paragraph 7 hereof, and performing his training and service therein.

9. Petitioner Philip W. Taylor satisfactorily completed his period of training and service in the land forces of the United States on the 5th day of February, 1946, and re-entered the employ of respondent Seattle Star, [6] Inc., on the 8th day of February, 1946, and continued in said employment continuously until the discontinuance of publication of said Seattle Star on the 13th of August, 1947, when he was discharged by reason thereof.

10. Petitioner Philip W. Taylor is a member in good standing of Seattle Newspaper Guild, Local 82, a local union chartered by American Newspaper Guild, a voluntary association.

11. Petitioner Philip W. Taylor hereby adopts paragraphs 11 and 12 of the John Randolph or first cause of action herein and makes the same a part hereof by reference and without repetition.

12. Petitioner Philip W. Taylor satisfactorily completed his period of training and service in the land forces of the United States on the 5th day of February, 1946, and on that date received a certificate of honorable discharge from the Army of the United States, evidencing such satisfactory completion.

13. That petitioner Philip W. Taylor was restored to his former position on February 8, 1946, and by virtue of his continuous employment covering a period of five years and six months (February 1942 to August 13, 1947), became entitled, on August 13, 1947, to receive severance pay, under the provisions of the contract referred to on the date of his dismissal for the period of eleven weeks at the rate of \$64.43 per week, or the total sum of Seven Hundred and Eight Dollars and Seventy-three Cents (\$708.73).

14. Respondents have refused and still refuse to pay petitioner Philip W. Taylor severance pay covering the period of his military service (a period of three years and six months) but have paid and petitioner [7] Philip W. Taylor has accepted under

duress, and not otherwise, the sum of Two Hundred Fifty-Seven Dollars and Seventy-two Cents (\$257.72), leaving a balance due and unpaid from respondents to petitioner Philip W. Taylor of the sum of Four Hundred Fifty-one Dollars and One Cent (\$451.01).

15. Petitioner Philip W. Taylor hereby adopts paragraph 16 of the John Randolph or first cause of action and makes the same a part hereof by reference and without repetition.

Wherefore, petitioners respectfully pray:

1. That the Court adjudge and decree that petitioners, upon their restoration to their former positions, after service in the armed forces of the United States, became entitled to all benefits offered by the employer pursuant to established rules and practices relating to employees or furlough or leave of absence in effect with the respondent Seattle Star, Inc., at the time of their induction into the army, as provided in subsection (e) of Sec. 308, Title 50, App., U.S.C.

2. That petitioner John Randolph have judgment against respondents in the sum of \$1543.50.

3. That petitioner Philip W. Taylor have judgment against respondents in the sum of \$451.01.

J. CHARLES DENNIS,
United States Attorney,
JOHN E. BELCHER,
Assistant United States
Attorney. [8]

United States of America,
State of Washington,
County of King—ss.

John Randolph being first duly sworn, on oath deposes and says:

That he is one of the petitioners in the above-entitled cause; that he has read said petition, knows the contents thereof, and that the same is true, as he verily believes.

/s/ JOHN RANDOLPH.

Subscribed and sworn to before me this 4th day of September, 1947.

[Seal] /s/ JOHN E. BELCHER,
Notary Public for the State of Washington, residing at Seattle.

[Endorsed]: Filed September 4, 1947. [9]

[Title of District Court and Cause.]

ANSWER TO PETITION FOR ENFORCEMENT OF VETERANS' RIGHTS

The defendants, Seattle Star, Inc., a corporation, and E. L. Skeel, as Liquidating Trustee of said corporation, in answer to the first cause of action alleged in plaintiffs' petition for enforcement of veterans rights under Act of September 16, 1940, as amended, admit, deny and allege as follows:

I.

Defendants have not sufficient knowledge or information to enable them to form a belief as to the truth of the allegations set forth in Paragraphs 1 and 10 of said petition and, therefore, deny the same and all thereof.

II.

Defendants admit the allegations in each of the following numbered Paragraphs of the first cause of action alleged in said petition, to-wit: Paragraphs 2, 3, 4, 6, 7, 8, 9, 12 and 13.

III.

Answering Paragraph 5 defendants admit that the petitioner John Randolph was a reporter of the defendant [10] corporation from 1938 to January 9, 1942, but deny each and every other allegation in said paragraph contained.

IV.

Defendants admit the allegations of Paragraph 11, except that they deny that the provision of said contract as recited in said Paragraph 11 was in force when the claimant Randolph entered the military service in 1942.

V.

Defendants deny each and every allegation in Paragraph 14 of said petition, except that they admit that the petitioner, John Randolph, was restored to employment with the Seattle Star on January 14, 1946, and that he became entitled on August 13, 1947, to receive severance pay, under the provisions of the contract referred to, on the date of his dismissal for the period of 14 weeks at the rate of \$73.50 per week, or a total of \$1029, and no more.

VI.

Defendants deny each and every allegation in Paragraph 15 of said petition, except that they admit that they have refused and still refuse to pay the petitioner, John Randolph, severance pay covering the period of military service and admit that they have heretofore offered plaintiff severance pay in the sum of \$1029.00. Defendants allege that they have offered and stand ready, willing and able to pay severance pay to said plaintiff, John Randolph, in the sum of \$1029.

VII.

Defendants deny each and every allegation in Paragraph 16. [11]

For further answer to the second cause of action alleged in said petition, defendants admit, deny and allege with respect to the paragraphs set forth therein as follows:

VIII.

Defendants have not sufficient knowledge or information to enable them to form a belief as to the truth of the allegations set forth in Paragraphs 1 and 10 of said second cause of action and, therefore, deny the same and all thereof.

IX.

Defendants admit the allegations in Paragraphs 2, 3, 7, 8, 9 and 12 of said second cause of action.

X.

Defendants deny each and every allegation in Paragraphs 5 and 6, except that defendants admit that the petitioner, Taylor, was employed by the defendant, Seattle Star, from February, 1942, to August 20, 1942, as a first year office boy.

XI.

Defendants make the same answer to Paragraph 11 of plaintiff's second cause of action as they made to Paragraphs 11 and 12 of plaintiffs' first cause of action.

XII.

Defendants deny each and every allegation of Paragraph 13, except that they admit that the petitioner, Taylor, was restored to employment by the Seattle Star on February 8, 1946, and that on August 13, 1947, he became entitled to receive severance pay, under the provisions of the contract referred to, on the date of his dismissal for a period of 4 weeks at the rate of \$64.43 per week, and no more.

XIII.

Defendants deny each and every allegation [12] in Paragraph 14 of said second cause of action, except that they admit that they have paid the claimant Taylor severance pay in the sum of \$257.72 and that they have refused and still refuse to pay said claimant severance pay covering his period of military service.

XIV.

Defendants make the same answer to Paragraph 15 of plaintiffs' second cause of action as they made to Paragraph 16 of plaintiffs' first cause of action.

Wherefore having fully answered plaintiffs' petition, defendants pray that the plaintiffs have and recover nothing herein and that said petition be dismissed in its entirety with prejudice and that the defendants have and recover of and from the plaintiffs their costs and disbursements herein to be taxed.

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,
E. L. SKEEL,
W. PAUL UHLMANN,
Attorneys for Defendants.

Received a true copy this 15th day of September, 1947.

JOHN E. BELCHER,
Assistant U. S. Attorney
for Plaintiffs.

[Endorsed]: Filed September 15, 1947. [13]

[Title of District Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated by and between the parties hereto through their respective counsel, as follows:

1. That Seattle Star, Inc., is, and at all of the times hereinafter mentioned was a corporation or-

ganized and existing under and by virtue of the laws of the State of Washington, and at the times hereinafter mentioned did maintain a place of business in Seattle, King County, Washington, and was the publisher of a daily newspaper known as "Seattle Star."

That said corporation ceased to carry on its publishing business on August 13, 1947, and is presently going through the process of voluntary dissolution and respondent, E. L. Skeel, is its duly qualified and acting Liquidating Trustee.

2. That the plaintiff John Randolph entered the employ of said corporation on or about September 24, 1936, and thereafter became a reporter on said Seattle Star in the year 1938 at a salary of \$20 per week, and that he was continuously so employed until the month of January, 1942, at which time he took leave to enter upon service in the United States Army. That at said time, the said John Randolph was classified as a second year reporter and received a salary from the Seattle Star of \$35.00 [14] per week.

3. That said John Randolph was inducted into the Armed Forces of the United States January 15, 1942, at Ft. Lewis, Washington, and was honorably discharged at Army Air Force Separation Base, Portland, Oregon, December 10, 1945, and on said date received from the Army of the United States a certificate of honest and faithful service to this country, a photostatic copy of which is attached to this stipulation as "Exhibit A."

4. That during the period from January, 1942, to January, 1946, the said John Randolph was in the Armed Forces of the United States and did no work and received no pay from the Seattle Star. That said John Randolph was, on January 14, 1946, restored to his former position as a reporter by the Seattle Star. That upon resumption of his duties on said date, the said John Randolph was classified as a sixth year reporter and was paid a weekly salary by the Seattle Star of \$65.00, and was thereafter dismissed upon the suspension of publication of said Seattle Star on August 13, 1947.

5. That the weekly salary of said John Randolph on said 13th day of August, 1947, and for a period of six months immediately prior thereto was \$73.50.

6. That "Exhibit B," attached hereto, is a true and correct copy of a written contract between the Seattle Star, then operating as Star Publishing Company, and the Seattle Newspaper Guild, effective October 5, 1940, and continuing until October, 1942.

7. That there was in full force and effect between the Seattle Star and the Seattle Newspaper Guild, from October, 1942, to January 2, 1944, a written contract which contained provisions for severance pay to employees, identical with those contained in [15] Article VIII of Exhibit "B", attached hereto, and provisions with respect to military service identical with those contained in Article X of said Exhibit "B."

8. That effective January 1, 1946, the said defendant, Seattle Star, Inc., and Seattle Newspaper

Guild, Local 82, entered into a new contract, a true printed copy of which is attached hereto as Exhibit "C."

9. That Article X of the contracts between the Seattle Star and the Seattle Newspaper Guild in force from October 5, 1940, to January 2, 1944, was identical in form with Article X as it appears in Exhibit "B" attached hereto. That the provisions of said Article X of the contracts in force between said Seattle Star and the Seattle Newspaper Guild from January 2, 1944, to the date of discharge of the claimants, Randolph and Taylor, on August 13, 1947, were identical with Article X in Exhibit "C." attached hereto, (being the identical contract attached to claimants' petition as Exhibit "A.")

10. That in computing the severance pay of plaintiff, John Randolph, defendants used a basis of 14 weeks (equivalent to seven years' service) and offered to pay the said John Randolph therefor at the rate of \$73.50 per week or a total of \$1029.00, and no more, which said John Randolph refused to accept.

11. That plaintiff, Philip W. Taylor entered the employ of defendant, Seattle Star, Inc., on to-wit: February 2, 1942, as a first year office boy and continued in such employment in that capacity at a weekly salary of \$17.65 until the month of August, 1942.

12. That Philip W. Taylor was inducted into the Army [16] of the United States in the month of August, 1942, at Ft. Lewis, Washington, and was

honorably discharged from said Armed Forces on the 5th day of February, 1946, and on said date received from the Army of the United States a certificate of honest and faithful service to this country, a photostatic copy of which is attached to this stipulation as Exhibit "D."

13. That during the period from August, 1942, to February, 1946, the said Philip W. Taylor was in the Armed Forces of the United States and did no work and received no pay from the Seattle Star. That the plaintiff, Philip W. Taylor, was, on February 8, 1946, restored to employment by the Seattle Star with the classification of a third year reporter at a salary of \$47.53 per week. That at the time of his discharge from employment by the Seattle Star, Inc., on August 13, 1947, the said Philip W. Taylor was classified as a fourth year reporter and was paid a weekly salary of \$64.43.

14. That in computing the severance pay of plaintiff, Philip W. Taylor, defendants used as a basis 4 weeks (equivalent of not to exceed $2\frac{1}{2}$ years of service) and offered to pay and did pay, and defendant accepted the sum of \$257.72, although the said Philip W. Taylor claims the amount due him to be for 11 weeks' severance pay (equivalent of five and one-half and less than six years' service), or \$708.73, leaving a claimed balance of \$451.01.

15. That all employees of defendant, Seattle Star, Inc., non-veterans and members of Seattle Newspaper Guild occupying similar positions and who did not serve in the Armed Forces during the war, were paid severance pay upon discharge by the

Seattle Star, Inc., based on the total years of full time [17] continuous employment with the Seattle Star, in accordance with the schedule set out in Article VIII of Exhibit "C" attached hereto.

Dated at Seattle, Washington, this 15th day of September, 1947.

J. CHARLES DENNIS,

United States Attorney,

JOHN E. BELCHER,

Assistant United States

Attorney,

Attorneys for Plaintiffs.

SKEEL, McKELVY, HENKE,

EVENSON & UHLMANN,

/s/ W. PAUL UHLMANN,

Attorneys for Defendants.

[Endorsed]: Filed September 15, 1947. [18]

EXHIBIT "B"

Contract between Seattle Newspaper Guild,
Local 82, of the American Newspaper Guild,
affiliated with Congress of Industrial Organi-
zations and The Seattle Star

* * *

October 5, 1940, to October 4, 1942

Article VIII.—Severance

1. Upon dismissal, an employee shall receive a written notice from the Publisher or his agents stating the cause for his dismissal if such written notice is requested by the employee.

2. Upon dismissal, any employee covered by this contract shall receive a cash severance pay in a lump sum in accordance with the following schedule:

Six months and less than one year.....	2	Weeks
One year and less than two years.....	3	"
Two years and less than two and one-half years	4	"
Two and one-half years and less than three years	5	"
Three years and less than three and one-half years	6	"
Three and one-half years and less than four years	7	"
Four years and less than four and one-half years	8	"
Four and one-half years and less than five years	9	"
Five years and less than five and one-half years	10	"
Five and one-half years and less than six years	11	"
Six years and less than six and one-half years	12	"
Six and one-half years and less than seven years	13	"
Seven years and less than seven and one-half years	14	"
Seven and one-half years and less than eight years	15	"
Eight years and less than eight and one-half years	16	"
Eight and one-half years and less than nine years	17	"
Nine years and less than nine and one-half years	18	"
Nine and one-half years and less than ten years	19	"
Ten years and less than ten and one-half years	20	"
Ten and one-half years and less than eleven years	21	"
Eleven years and less than eleven and one-half years	22	"
Eleven and one-half and less than twelve years	24	"
Twelve years and less than twelve and one-half years	26	"
Twelve and one-half years and over.....	28	"

3. Severance pay shall be determined on the basis of the highest weekly salary received by the employee during the last six (6) months of service with the Publisher.

4. In computing severance pay the length of service of the employee shall be the total years of full time continuous employment in the Scripps League.

5. By written agreement with the Publisher, employees may be granted leaves of absence without prejudice to continuing service in the determination of severance pay, but [21] time spent on such leave shall not count as service time.

6. In the event of charges by the Publisher of attempted self-provoked discharge or charges of dishonesty it is mutually agreed that the execution of the severance provision of this contract shall rest with the Guild, whose decision shall be binding, and no employee shall have any right under said provision that it is not in conformity with the decision of the Guild.

7. Any employee, after twenty-five (25) years of service may retire voluntarily, or may be retired by the Publisher, and in either event receive the dismissal indemnity as above set forth.

8. From severance pay the Publisher may deduct any levy or tax to which the employee is subject under the State or Federal employment legislation.

9. In the event of the death of an employee while on the payroll of the Publisher, the Publisher shall

pay his beneficiary or estate, whichever the employee designates, an amount equal to the amount of severance pay to which the employee would have been entitled upon dismissal.

* * * * *

Article X.—Military Service

1. The Publisher agrees that all employees who leave their jobs to serve in the armed forces of the United States or their adjuncts shall be granted a leave of absence. The Publisher further agrees that such employee, provided he makes application within sixty (60) days after honorable discharge from active service or duty, shall then be reinstated to the same or comparable position with severance pay rating and other rights under this agreement unimpaired except that such leave may be deducted in computing severance [22] pay. In the event that an employee by reason of disability is unable to resume employment, the Publisher agrees to pay such employee the amount of severance to which he would have been entitled upon dismissal.

2. It is understood between the Guild and the Publisher that persons employed to replace employees called to military service need not be retained upon the return of the former employees, but that such persons shall enjoy the full benefits of this contract during the period of their employment. [22-a]

* * * * *

EXHIBIT "C."

Contract between Seattle Star, Inc., and Seattle Newspaper Guild.

Effective January 1, 1946

Article VIII.—Severance

1. Upon dismissal, an employee shall receive a written notice from the Publisher or his agents stating the cause for his dismissal if such written notice is requested by the employee.

2. Upon dismissal, any employee covered by this contract shall receive a cash severance pay in accordance with the following schedule:

Six months and less than one year.....	2 Weeks
One year and less than two years.....	3 "
Two years and less than two and one-half years	4 "
Two and one-half years and less than three years	5 "
Three years and less than three and one-half years	6 "
Three and one-half years and less than four years	7 "
Four years and less than four and one-half years	8 "
Four and one-half years and less than five years	9 "
Five years and less than five and one-half years	10 "
Five and one-half years and less than six years	11 "
Six years and less than six and one-half years	12 "
Six and one-half years and less than seven years	13 "
Seven years and less than seven and one-half years	14 "
Seven and one-half years and less than eight years	15 "
Eight years and less than eight and one-half years	16 "

Eight and one-half years and less than nine years	17	''
Nine years and less than nine and one-half years	18	''
Nine and one-half years and less than ten years	19	''
Ten years and less than ten and one-half years	20	''
Ten and one-half years and less than eleven years	21	''
Eleven years and less than eleven and one-half years	22	''
Eleven and one-half and less than twelve years	24	''
Twelve years and less than twelve and one-half years	26	''
Twelve and one-half years and over.....	28	''

3. Severance pay shall be determined on the basis of the highest weekly salary received by the employee during the last six (6) months of service with the Publisher.

4. In computing severance pay the length of service of the employee shall be the total years of full time continuous employment by the Seattle Star.

5. In the event of charges by the Publisher of attempted self-provoked discharge or charges of dishonesty, it is mutually agreed that the execution of the severance provision of this contract shall rest with the Guild, whose decision shall be binding, and no employee shall have any [25] right under said provision that is not in conformity with the decision of the Guild.

6. By written agreement with the Publisher, employees may be granted leaves of absence without prejudice to continuing service in the determination

of severance pay, but time spent on such leave shall not count as service time.

7. Any employee after twenty-five (25) years of service may retire voluntarily, or may be retired by the Publisher, and in either event receive the dismissal indemnity as above set forth.

8. From severance pay the Publisher may deduct any levy or tax to which the employee is subject under the State or Federal employment legislation.

9. In the event of the death of an employee while on the payroll of the Publisher, the Publisher shall pay his beneficiary or estate, whichever the employee designates, an amount equal to the amount of severance pay to which the employee would have been entitled upon dismissal.

* * * * *

Article X.—Military Service

An employee who is required by the United States or any subsidiary thereof to enter any kind of service, military or otherwise, which takes him out of the employment of the Publisher, or who, while the United States is at war, voluntarily enters into any of the military armed services of the United States, or who is released from his job as a result of any government order or ruling, shall be deemed to be an employee on leave of absence, and shall resume his position or a comparable one within two (2) weeks from date of his notice of desire to resume employment, with dismissal pay rating and other rights under the contract unimpaired. [26]

Application for resumption of employment must be made within ninety (90) days of termination of such service, making reasonable allowance for return to place of employment.

In the event an employee by reason of disability is unable to resume employment, the Publisher agrees to pay such employee the amount of severance to which he would have been entitled upon dismissal. To protect an employee granted military leave in the event that such employee by reason of death is unable to resume employment, the Publisher agrees that from January 2, 1944, the Publisher will pay \$1.00 per month towards the Government Insurance carried by such employee. This payment is sufficient to purchase, at current rates, \$1,500.00 Government Life Insurance and the disability provisions incidental thereto.

An employee promoted or transferred to take the place of one entering service referred to in this military clause may, upon resumption of employment by such person, be returned to his former position and salary, but at not less than the then current minimums for that position. Any employee so promoted or transferred, and while such promotion or transfer is temporary, shall receive credit for his employment in the experience rating to which promoted or transferred, or position from which transferred, as may be mutually agreed.

An employee hired as a replacement for one entering service referred to above, shall be covered by all the provisions of this agreement, except by the

military clause, and except that such employee, on entering such service shall be construed to be a dismissed employee and shall be given accumulated dismissal pay.

An employee hired as a replacement for one entering such service, competency being equal, shall be given preference [26-a] over any new employee in filling a vacancy other than the one caused by an employee entering such service.

An employee hired as a replacement for one entering such service shall be given written notice to that effect at the time of such employment or promotion, copy of which notice is to be sent to the Guild.

* * * * *

[Title of District Court and Cause.]

STATEMENT OF FACTS

This action was brought by two employees of the newspaper "Seattle Star" for recovery of full severance pay upon their dismissal when that newspaper suspended publication in August, 1947.

Both plaintiffs served in the armed forces during World War II and upon returning to their positions with the "Seattle Star" were accorded full seniority rights as to wages. When, however, the Star suspended publication, the plaintiffs, pursuant to the terms of their union contract, were denied

the benefit of having included in the computation of their severance pay (based upon the number of years of continuous service in the newspaper's employ) the time served by them in the armed forces of the United States, although other employees of defendant who did not serve in the military were given full severance pay.

The Court held that the union contract excluding from the computation of such severance pay the time spent in the military service is in conflict with the Act of Congress which provides that veterans shall have the other benefits enjoyed by those employees who were not in the service; and that plaintiffs are entitled to full payment of severance benefits including their years in military service, notwithstanding the union contract provisions to the contrary.

[Endorsed]: Filed October 23, 1947. [28]

In the District Court of the United States for the
Western District of Washington, Northern
Division

No. 1872

JOHN RANDOLPH and PHILIP W. TAYLOR,
Plaintiffs,

vs.

SEATTLE STAR, INC., et al.,
Defendants.

Before: The Honorable John C. Bowen,
District Judge.

Seattle, Washington, September 14, 1947, 2:00 P.M.

COURT'S DECISION

The Court: This statute of Congress, Title 50, Section 308 Appendix, was a humane measure for the protection of the soldiers and sailors and others in the military service in respect to [29] their employment while they were absent in the military service. The public policy therein expressed must of necessity have a liberal construction. If we admit in this case that there is a conflict between the union contract of employment relating to all the employees of the Seattle Star and this statute, it seems to me that the policy of the statute must be upheld to the exclusion of the conflicting provisions of the agreement between the union, allegedly representing these employees, and the employer, the Seattle Star.

The conflict between the statute and the work contract would be more explicit if, instead of "other benefits," the statute in subsection (c) had said "severance pay." But the statutory provision that "returned soldiers shall be entitled to participate in insurance or other benefits offered by the employer" (in effect, to the other employees) certainly includes severance pay. It is all-inclusive. And if we fail to apply in favor of these veterans the same statutory treatment as to severance pay which was accorded the other employees, then these returned soldiers—veterans of the second world war—are not participating, as they are entitled to under the statute, in such other benefits including severance pay.

If it could be said, *arguendo*, that some doubt is thrown upon the meaning of the statute as applied to the kind of benefit here involved—namely, severance pay benefit—by reason of the fact that that benefit was not mentioned by the statute expressly but [30] was expressly mentioned in the work contract wherein such benefit was excluded by paragraph 5, then such doubt should be by the Court resolved in favor of the veteran, under the rule requiring liberal interpretation of a statute for the relief of veterans.

However, I do not see how it is possible or these plaintiffs, who are war veterans, to enjoy the other benefits offered by the employer to other employees if the plaintiffs are denied this particular benefit of severance pay secured to them by the statute on a parity with other employees who were continu-

ously on active duty with the employer during the period of time that the plaintiffs were in the war service. It seems clear to the Court that to give effect to the contract provision that time spent by plaintiff veterans on military leave should not be included in the computation of their severance pay would clearly be in conflict with the Act of Congress which provides that these veterans upon return from active service with the military forces shall have the other benefits enjoyed by those employees who did not go into the service.

For the reasons stated by the Court, the Court finds, concludes and decides in favor of the plaintiffs for the amounts respectively alleged in the complaint.

[Endorsed]: Filed September 22, 1947. [31]

[Title of District Court and Cause.]

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

This matter came on regularly for hearing before the Court sitting without a jury on the 16th day of September, 1947, the plaintiffs being represented by J. Charles Dennis, United States Attorney, and John E. Belcher, Assistant United States Attorney, defendant, Seattle Star, Inc., a corporation, and E. L. Skeel, its Liquidating Trustee, being represented by their attorneys, Skeel, McKelvy, Henke, Even-son & Uhlmann, and the parties having stipulated

the facts, the court having considered the respective briefs filed on behalf of the respective parties, and having heard oral argument of counsel for all of the parties, and being fully advised in the premises, now makes its

Findings of Fact

I.

That Seattle Star, Inc., is, and at all of the times hereinafter mentioned was a corporation organized and existing under and by virtue of the laws of the State of Washington, and at the times hereinafter mentioned did maintain a place of business in Seattle, King County, Washington, and was the publisher of a daily newspaper known as "Seattle Star," which ceased publication on August 13, 1947, and is now being voluntarily dissolved by E. L. Skeel, as Liquidating Trustee. [32]

II.

That the plaintiff John Randolph entered the employ of said corporation on or about September 24, 1936, and thereafter became a reporter on said Seattle Star in the year 1938 at a salary of \$20 per week, and that he was continuously so employed until the month of January, 1942, at which time he took leave to enter upon service in the United States Army. That at said time, the said John Randolph was classified as a second year reporter and received a salary from the Seattle Star of \$35.00 per week.

III.

That said John Randolph was inducted into the Armed Forces of the United States January 15, 1942, at Ft. Lewis, Washington, and was honorably discharged at Army Air Force Separation Base, Portland, Oregon, December 10, 1945, and on said date received from the Army of the United States a certificate of honest and faithful service to this country.

IV.

That during the period from January, 1942, to January, 1946, the said John Randolph was in the Armed Forces of the United States and did no work and received no pay from the Seattle Star. That said John Randolph was, on January 14, 1946, restored to his former position as a reporter by the Seattle Star. That upon resumption of his duties on said date, the said John Randolph was classified as a sixth year reporter and was paid a weekly salary by the Seattle Star of \$65.00, and was thereafter dismissed upon the suspension of publication of said Seattle Star on August 13, 1947.

V.

That the weekly salary of said John Randolph on said 13th day of August, 1947, and for a period of six months immediately prior thereto was \$73.50.

VI.

That at the time of the entry of both plaintiffs into the armed forces of the United States in 1942,

the employer, Seattle Star, Inc., had in effect a schedule providing for the payment to its employees of severance pay upon dismissal, said schedule providing for the payment to the employee of a certain number of weeks' pay, ranging from two weeks' pay to 28 weeks' pay, dependent upon the number of years of continuous service of the employee with the employer.

VII.

That in computing the severance pay of plaintiff, John Randolph, defendants used a basis of 14 weeks (equivalent to seven years' service) and offered to pay the said John Randolph therefor at the rate of \$73.50 per week or a total of \$1029.00, and no more, which said John Randolph refused to accept.

VIII.

That plaintiff, Philip W. Taylor, entered the employ of defendant, Seattle Star, Inc., on February 2, 1942, as a first-year office boy and continued in such employment in that capacity at a weekly salary of \$17.65 until the month of August, 1942.

IX.

That Philip W. Taylor was inducted into the Army of the United States in the month of August, 1942, at Ft. Lewis, Washington, and was honorably discharged from said Armed Forces on the 5th day of February, 1946, and on said date received from the Army of the United States a certificate of honest and faithful service to this country, a photostatic

copy of which is attached to the stipulation as "Exhibit D." [34]

X.

That during the period from August, 1942, to February, 1946, the said Philip W. Taylor was in the Armed Forces of the United States and did no work and received no pay from the Seattle Star. That the plaintiff, Philip W. Taylor, was, on February 8, 1946, restored to employment by the Seattle Star with the classification of a third year reporter at a salary of \$47.53 per week. That at the time of his discharge from employment by the Seattle Star, Inc., on August 13, 1947, the said Philip W. Taylor was classified as a fourth year reporter and was paid a weekly salary of \$64.43.

XI.

That in computing the severance pay of plaintiff, Philip W. Taylor, defendants used as a basis 4 weeks (equivalent of not to exceed 2½ years of service) and offered to pay and did pay, and defendant accepted the sum of \$257.72, although the said Philip W. Taylor claims the amount due him to be for 11 weeks' severance pay (equivalent of five and one-half and less than six years' service), or \$708.73, leaving a claimed balance of \$451.01.

XII.

That all employees of defendant, Seattle Star, Inc., non-veterans and members of Seattle Newspaper Guild occupying similar positions and who did not serve in the Armed Forces during the war,

were paid severance pay upon discharge by the Seattle Star, Inc., based on the total years of full-time continuous employment with the Seattle Star, in accordance with the schedule set out in Article VIII of "Exhibit C," attached to the stipulation.

XIII.

That the contracts attached to the stipulation of facts on file herein and identified as Exhibits "B" and "C" thereof were in full force and effect during the times indicated in paragraphs 6, 7, 8 and 9 of said stipulation of facts.

XIV.

The Court further finds that seniority rights as to wages were accorded plaintiffs upon their return to their respective employments with defendant Seattle Star, Inc., at the time of their re-employment, but were denied the benefit of having included in the computation of their severance pay the time served by them in the Armed Forces of the United States, while other employees of defendant who did not so serve but continued to carry on their usual duties were given full severance pay upon their dismissal.

From the foregoing Findings of Fact, the Court concludes, as matter of law:

I.

That the statute here in question—Subsection (c), Section 308, Title 50, App., U.S.C.A., is to be liberally construed to effectuate the Congressional intent that plaintiffs and others similarly situated who

are veterans of World War II are entitled to full severance pay without deducting from the computation thereof the time they respectively served in the armed forces of the United States during World War II, notwithstanding union contract provisions to the contrary.

II.

That plaintiff John Randolph is entitled to judgment [36] against defendants in the sum of One Thousand Five Hundred Forty-three and 50/100 Dollars (\$1,543.50).

III.

That plaintiff Philip W. Taylor is entitled to judgment against defendants in the sum of Four Hundred Fifty-one and 01/100 Dollars (\$451.01), being the difference between Seven Hundred Eight and 75/100 Dollars (\$708.75) due him for full severance pay and the sum of Two Hundred Fifty-seven and 72/100 Dollars (\$257.72) heretofore paid him by defendants.

The defendants have excepted to the foregoing Conclusions of Law, which exception is allowed.

Done in open court this 19th day of September, 1947.

/s/ JOHN C. BOWEN,

United States District Judge.

Approved as to form:

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,
W. PAUL UHLMANN,
Attorneys for Defendants.

[Endorsed]: Filed September 19, 1947.

United States District Court, Western District of
Washington, Northern Division

No. 1872

JOHN RANDOLPH and PHILIP W. TAYLOR,
Plaintiffs,

vs.

SEATTLE STAR, INC., a Corporation, and E. L.
SKEEL, Liquidating Trustee,
Defendants.

JUDGMENT

This matter came on regularly for trial before the court sitting without a jury on the 15th day of September, 1947, plaintiffs being represented by J. Charles Dennis, United States Attorney, and John E. Belcher, Assistant United States Attorney, defendants being represented by their attorneys, Skeel, McKelvy, Henke, Evenson & Uhlmann. the facts being stipulated in writing, and the court having duly considered the evidence and respective counsel having filed written briefs and the court having heard and considered the facts and the law and being fully advised in the premises, and having heretofore made and entered its findings of fact and conclusions of law, now, therefore, it is

Ordered, Adjudged and Decreed that the plaintiff, John Randolph, have and recover judgment, and judgment is hereby entered in favor of John Randolph and against the defendants Seattle Star, Inc., a corporation, and E. L. Skeel in his official capacity

as Liquidating Trustee of said Seattle Star, Inc., a corporation, only, in the sum of One Thousand Five Hundred Forty-three and 50/100 Dollars (\$1,543.50); and it is [38]

Further Ordered, Adjudged and Decreed that the plaintiff Philip W. Taylor have and recover judgment, and judgment is hereby entered in favor of Philip W. Taylor and against the defendants Seattle Star, Inc., a corporation, and E. L. Skeel in his official capacity as Liquidating Trustee of said Seattle Star, Inc., a corporation, only, in the sum of Four Hundred Fifty-one and 01/100 Dollars (\$451.01).

To all of which defendants except, and exception is allowed.

Done in open court this 19th day of September, 1947.

JOHN C. BOWEN,

United States District Judge.

Presented by:

JOHN E. BELCHER,

Assistant United States
Attorney.

Approved as to form:

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,

W. PAUL UHLMANN,
Attorneys for Defendants.

[Endorsed]: Filed September 19, 1947. [39]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that the Seattle Star, Inc., a corporation, and E. L. Skeel, Liquidating Trustee of the said corporation, defendants above named, hereby appeal to the Circuit Court of Appeals for the 9th Circuit from the final judgment entered in this action on the 19th day of September, 1947.

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,

E. L. SKEEL,

W. PAUL UHLMANN,
Attorneys for Defendants.

[Endorsed]: Filed December 16, 1947. [40]

[Title of District Court and Cause.]

SUPERSEDEAS BOND

Know all men by these presents that we, the Seattle Star, Inc., a corporation, and E. L. Skeel, in my official capacity as Liquidating Trustee of the said Seattle Star, Inc., but not personally, acknowledge ourselves to be jointly indebted to John Randolph and Philip W. Taylor, appellees in the above cause in the sum of Two Thousand Two Hundred Fifty and No/100 Dollars (\$2,250.00) conditioned that, whereas on the 19th day of September, A.D. 1947, in the District Court of the United States for the Western District of Washington, Northern Division, in a suit in that court wherein John Randolph and Philip W. Taylor were plaintiffs, and the Seattle Star, Inc., and E. L. Skeel as Liquidating Trustee of the Seattle Star, Inc., were defendants, numbered on the Civil Docket as No. 1872, judgment was rendered against the said defendants and in favor of the said John Randolph in the sum of \$1543.50, and against the said defendants and in favor of the said Philip W. Taylor in the sum of \$451.01, and the said defendants having filed in the office of the clerk of the said district court Notice of Appeal to the United States Circuit Court of Appeals [41] for the 9th Circuit.

Now the condition of the above obligation is such that if the said Seattle Star, Inc., and E. L. Skeel as Liquidating Trustee of the said Seattle Star, Inc., shall prosecute their appeal to effect and sat-

isfy the said judgment in full, together with costs, interest and damages for delay, if for any reason the appeal is dismissed, or if the judgment is affirmed and satisfied in full, such modification of the judgment and such costs, interest and damages as the Appellate Court may judge and award, then the above obligation is void unless it remains in full force and effect.

SEATTLE STAR, INC.,
By /s/ E. L. SKEEL,
Liquidating Trustee.

/s/ E. L. SKEEL,
As Liquidating Trustee,
Principals.

CONTINENTAL
CASUALTY CO.,
[Seal] By /s/ L. G. GREWE,
Surety.

Approved:

/s/ LLOYD L. BLACK,
Judge.

/s/ J. CHARLES DENNIS,
U. S. Attorney.

Presented by:

/s/ W. PAUL UHLMANN.

[Endorsed]: Filed December 16, 1947. [42]

[Title of District Court and Cause.]

APPELLANTS' DESIGNATION OF POINTS
TO BE RELIED UPON ON APPEAL

Come now the appellants and hereby designate the following as the points to be relied upon by them on appeal:

1. Under Title 50, U.S.C.A., Section 308 (the Selective Training and Service Act of 1940) the rights of each claimant to employment benefits were determined by the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time that claimant was inducted into the Armed Forces.
2. Under the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time of induction of each claimant, the time spent by any employee of the Seattle Star in the Armed Forces was not to be included in the computation of severance pay for that employee.

Dated at Seattle, Washington, this 19th day of December, 1947.

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,
By E. L. SKEEL,
W. PAUL UHLMANN,
Attorneys for Defendants.

Received a copy of the within Appellants' Designation this 19th day of December, 1947.

J. CHARLES DENNIS,
Attorney for Plaintiffs.

[Endorsed]: Filed December 19, 1947. [43]

[Title of District Court and Cause.]

APPELLANTS' DESIGNATION OF
CONTENTS OF RECORD ON APPEAL

Come now the appellants and hereby designate the following portions of the record to be included in the Record on Appeal:

1. Petition for enforcement of veterans rights.
2. Answer to Petition for enforcement of veterans rights.
3. Stipulation of facts.
4. Only Article VIII and Article X of Exhibit "B" of Stipulation of Facts.
5. Only Article VIII and Article X of Exhibit "C" of Stipulation of Facts.
6. Findings of Fact and Conclusions of Law.
7. Judgment.
8. Notice of Appeal.
9. Supersedeas Bond.
10. Appellants' designation of contents of record on appeal.

Dated at Seattle, Washington, this 19th day of December, 1947.

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,

By E. L. SKEEL,

W. PAUL UHLMANN,

Attorneys for Defendants.

Received a copy of the within Appellants' Designation this 19th day of December, 1947.

J. CHARLES DENNIS,

Attorney for Plaintiffs.

[Endorsed]: Filed December 19, 1947. [44]

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO TRANSCRIPT
OF RECORD ON APPEAL

United States of America,
Western District of Washington—ss.

I, Millard P. Thomas, Clerk of the United States District Court for the Western District of Washington, do hereby certify that the foregoing typewritten transcript of record, consisting of pages numbered 1 to 44, inclusive, is a full, true and complete copy of so much of the record, papers and other proceedings in the above and foregoing entitled cause as is required by Designation of Record filed and shown herein, as the same remain of record and on file in the office of the Clerk of said District Court at Seattle and that the same constitute the record on appeal from the Judgment of said United States District Court for the Western District of Washington to the United States *Circuit of Appeals* for the Ninth Circuit, dated September 19, 1947.

I further certify that the following is a true and correct statement of all expenses, costs, fees and charges incurred in my office for preparing record on appeal herein, to the United States Circuit Court of Appeals for the Ninth Circuit, to-wit:

Clerk's fees for making record, certificate or return.

24 pages at 40c.....	\$ 9.60
19 pages at 10c.....	1.90
Appeal fee	5.00
<hr/>	
TOTAL.....	\$16.50

I further certify that the costs of this record have been paid by the attorneys for appellant.

In witness whereof I have hereunto set my hand and affixed the official seal of said District Court at Seattle, in said District, this 29th day of December, 1947.

[Seal] MILLARD P. THOMAS,
 Clerk,
By /s/ TRUMAN EGGER,
 Chief Deputy Clerk.

[Endorsed]: No. 11828. United States Circuit Court of Appeals for the Ninth Circuit. Seattle Star, Inc., a Corporation, and E. L. Skeel, Liquidating Trustee, Appellants, vs. John Randolph and Philip W. Taylor, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the Western District of Washington, Northern Division.

Filed January 3, 1948.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

No. 11828

SEATTLE STAR, Inc., a Corporation, and E. L.
SKEEL, Liquidating Trustee,

Appellants,

vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

APPELLANTS' DESIGNATION OF POINTS
TO BE RELIED UPON ON APPEAL

Come now the appellants and hereby designate the following as the points to be relied upon by them on appeal:

1. Under Title 50, U.S.C.A., Section 308 (the Selective Training and Service Act of 1940) the rights of each claimant to employment benefits were determined by the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time that claimant was inducted into the Armed Forces.
2. Under the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time of induction of each claimant, the time spent by any employee of the Seattle Star in the Armed Forces was not to be included in the computation of severance pay for that employee.

3. The rights given to a reemployed veteran by Title 50, U.S.C.A., Section 308 (the Selective Training and Service Act of 1940) are limited in time, and in the instant case expired prior to the termination of employment of the appellees.

Dated at Seattle, Washington, this 9th day of February, 1948.

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,

/s/ E. L. SKEEL,

/s/ W. PAUL UHLMANN,

Attorneys for Appellants.

Received a copy of the within Appellant's Designation of Points this 9th day of February, 1948.

/s/ J. CHARLES DENNIS,

Attorney for Appellees.

[Endorsed]: Filed February 10, 1948.

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE STAR, a corporation and E. L.
SKEEL, Liquidating Trustee, *Appellants*,

vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

UPON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLANTS

SKEEL, McKELVY, HENKE,
EVENSON & UHLMANN,
E. L. SKEEL,
W. PAUL UHLMANN,
Attorneys for Appellants.

Office and Postoffice Address:
914 Insurance Building,
Seattle 4, Washington.

IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE STAR, a corporation and E. L.
SKEEL, Liquidating Trustee, *Appellants*,

vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

UPON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLANTS

SKEEL, MCKELVY, HENKE,
EVENSON & UHLMANN,
E. L. SKEEL,
W. PAUL UHLMANN,
Attorneys for Appellants.

Office and Postoffice Address:
914 Insurance Building,
Seattle 4, Washington.

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IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE STAR, a corporation and E. L.
SKEEL, Liquidating Trustee,

Appellants,

vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,

Appellees.

No. 11828

UPON APPEAL FROM THE UNITED STATES DISTRICT
COURT FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLANTS

JURISDICTIONAL STATEMENT

This is an appeal from the final judgment entered in favor of the appellees in the above entitled case by the United States District Court for the Western District of Washington, Northern Division. The action (R. 2) was one brought on behalf of two re-employed veterans under the provisions of the Selective Training and Service Act of 1940 (Title 50 U.S.C.A. App., Sec. 301, *et seq.*). Section 8(e) of that Act (Title 50 U.S.C.A. App., Sec. 308(e)) provides as follows:

“In case any private employer fails or refuses to comply with the provisions of subsection (b)

or subsection (c), the District Court of the United States for the district in which such private employer maintains a place of business shall have power, upon the filing, of a motion, petition, or other appropriate pleading by the person entitled to the benefits of such provisions, to specifically require such employer to comply with such provisions, and, as an incident thereto, to compensate such person for any loss of wages or benefits suffered by reason of such employer's unlawful action. * * *

This appeal from that judgment is taken pursuant to the provisions of 28 U.S.C.A., Sec. 225, which provides that:

“(a) The circuit courts of appeal shall have appellate jurisdiction to review by appeal or writ of error, final decisions—

“First. In the district courts, in all cases save where a direct review of the decision may be had in the Supreme Court under Section 345 of this title.”

STATEMENT OF THE CASE

The facts of this case have been stipulated by counsel (R. 15 to 20). The significant facts are as follows: Appellee John Randolph first entered the employ of the Seattle Star on or about September 24, 1936, and was thereafter continuously employed by the Star until January, 1942, when he was inducted into the United States Army. Upon his honorable discharge from the Army, Randolph was re-employed by the Star and restored to his former position on January 14, 1946.

Appellee Philip W. Taylor first entered the employ of the Seattle Star on or about February 2, 1942, and was thereafter continuously employed by the Star until August, 1942, when he was inducted into the United States Army. Upon his honorable discharge from the Army, Taylor was re-employed by the Star and restored to his former position on February 8, 1946.

At the time of the induction into the Armed Forces of each of the Appellees there was, in effect, between the Seattle Star and the Seattle Newspaper Guild, Local 82, of the American Newspaper Guild, a contract which included provisions for severance pay. This contract (R. 20) called for the payment of severance pay computed on the basis of the period of full time continuous employment of the employee with the Scripps League (Seattle Star) but provided that time spent on leave of absence should not count as service time in the computation of that severance pay.

The Star ceased publication on August 13, 1947, and at that time Randolph and Taylor, along with a great many other employees, were relieved from further employment. Each employee was at that time paid severance pay on the basis of his years of full time continuous employment with the Seattle Star, but in the computation of the full time continuous employment of the Appellees, Randolph and Taylor, the time which they spent in the Armed Forces was not included.

Both Appellees claimed that by virtue of the Selective Training and Service Act of 1940, additional

severance pay was due them for the time which they had spent in the Armed Forces. Upon the rejection of their claims by Appellants this suit was brought on behalf of the Appellees by the United States District Attorney. The trial court entered final judgment for Randolph and against the Appellants in the sum of \$1,543.50, and for Taylor and against Appellants in the sum of \$451.01, the court holding that under the Selective Training and Service Act of 1940 the time-in-service of veterans must be included in the computation of their severance pay.

SPECIFICATIONS OF ERROR

The district court erred in the following respects:

- (1) Entering judgment in favor of the Appellees, Randolph and Taylor for recovery against the defendants;
- (2) Refusing to dismiss the action of the plaintiffs below (appellees); and
- (3) Refusing to enter judgment in favor of the defendants below (appellants).

SUMMARY OF ARGUMENT

The Selective Training and Service Act of 1940 provided that a re-employed veteran is entitled to the various benefits offered by the employer in accordance with the established practices relating to employees on leave of absence as of the time of the induction of the re-employed veteran. The contract between the Seattle Star and the bargaining agent of its employees, including the Appellees, provided that time on leave of absence should not be included in the compu-

tation of severance pay. We submit, therefore, that time spent in the Armed Forces should likewise not be included in the computation of severance pay.

If it be held, however, that a veteran occupies a preferential position upon his return and that his time in service must be included in the computation of severance pay so long as he occupies that position, we submit that the Appellees lost their preferential position upon the termination of the first year of their re-employment and that, as a result, they must be treated no differently from non-veterans in the computation of severance pay.

ARGUMENT

I.

Under Title 50 U.S.C.A. App. Sec. 308, the Selective Training and Service Act of 1940, the Rights of Each Claimant to Employment Benefits Were Determined by the Contract in Effect Between the Seattle Star and the Seattle Newspaper Guild at the time that claimant was inducted into the armed forces.

The relevant portions of the Selective Training and Service Act of 1940 (Title 50 U.S.C.A. App. Sec. 301 *et seq.*) are as follows:

“Sec. 308(a) Any person inducted into the land or naval forces under this Act for training and service, who, in the judgment of those in authority over him, satisfactorily completes his period of training and service * * * shall be entitled to a certificate to that effect upon the completion of such period of training and service * * *.

(b) In the case of any such person who, in order

to perform such training and service, has left or leaves a position, other than a temporary position, in the employ of any employer and who

(1) receives such certificate,

(2) is still qualified to perform the duties of such position, and

(3) makes application for reemployment within forty days after he is relieved from such training and service—

(B) if such position was in the employ of private employer, such employer shall restore such person to such position or to a position of like seniority, status, and pay unless the employer's circumstances have so changed as to make it impossible or unreasonable to do so;

(c) Any person who is restored to a position in accordance with the provision of paragraph (A) or (B) of sub-section (b) shall be considered as having been on furlough or leave of absence during his period of training and service in the land or naval forces, shall be so restored without loss of seniority, shall be entitled to participate in insurance or other benefits offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence in effect with the employer at the time such person was inducted into such forces, and shall not be discharged from such position without cause within one year after such restoration."

By virtue of the Selective Training and Service Act a returning veteran is clearly entitled to participate in benefits offered by his former employer to the employees of the latter; but—that right is not unlimited. By the express words of Sec. 308(c) the

returning veteran is entitled to participate in those benefits only in pursuance to those "rules and practices relating to employees on furlough or leave of absence" which were in effect at the time that the returning veteran was inducted into the Armed Forces.

It is manifest therefore that one can determine the benefits to which a returning veteran is entitled only by determining the benefits to which he would have been entitled had he not been inducted into the Armed Forces but rather had taken a furlough or leave of absence. If the time spent by him as a civilian employee on furlough or leave of absence would have been counted in determining his rights to benefits, then the time spent by him in the Armed Forces would likewise be counted in determining his rights to benefits. If the time spent by him as a civilian on furlough or leave of absence would have been disregarded in determining his rights to benefits, then the time spent by him in the Armed Forces must likewise be disregarded.

It is difficult to rephrase Sec. 308(c) so as to clarify the intent of Congress. The need for clarification, as a matter of fact, is absent, for in this section there is not the slightest trace of ambiguity. By its terms the rights of a returning veteran are declared to be exactly equal, no greater, no less, than the rights of an employee who has taken a furlough for an equal period of time. The statute establishes an equation of rights and in determining the rights of a returning veteran the terms of that equation must be strictly

observed lest the intent of Congress be defeated. In awarding judgment to the plaintiffs in this action, the trial court said (R. 31):

“* * * I do not see how it is possible for these plaintiffs, who are war veterans, to enjoy the other benefits offered by the employers to other employees if the plaintiffs are denied this particular benefit of severance pay secured to them by the statute on a parity with other employees who were continuously on active duty with the employer during the period of time that the plaintiff's were in the war service.”

We submit, however, that this statement on the part of the trial court indicates a misapprehension on its part of the statutory provision made for the returning veteran. The lower court indicates the statute was designed to create a parity between returning veterans and the employees “who were continuously on active duty with the employer” during the period of military service of the returning veteran.

Analysis of the statute reveals, however, as we have shown above, that the statute was designed not to create a parity between the returning veteran and employees “who were continuously on active duty with the employer” but rather to create a parity between the returning veterans and employees who may have been on furlough or leave of absence for an equivalent period of time. The words of the statute permit of no other interpretation.

Other courts in construing this statute have not disregarded the words of Sec. 308(c) making the rights of a returning veteran to various benefits

equivalent to the rights of an employee on furlough or leave of absence. For example, in *Lord Manufacturing Company v. Nemez* (1946) 65 F. Supp. 711, at page 725 the court said:

“* * * A person who entered military service shall be considered as having been on furlough or leave of absence during his period of active military service * * *.”

In *Trailmobile Company v. Whirls* (1946) 154 F. (2d) 866 at page 869 the court stated:

“* * * the person so restored to such position shall be considered as having been on furlough or leave of absence during his period of military service and shall be so restored without loss of seniority.”

In *Fishgold v. Sullivan Drydock and Repair Corporation* (1946) 154 F.(2d) 785 at page 792 the dissenting opinion of Chase, C.J., stated:

“* * * the position carries with it the right of the former employee thus re-employed to be treated as though he had been ‘on furlough or leave of absence during his period of training and service in the land or naval forces’ * * *.”

In *Feore v. North Shore Bus Company* (1947) 161 F.(2d) 552 at page 554, the court said:

“Sec. 8(c) of the Act requires that the veteran be considered as on furlough or leave of absence during his period of training and service.”

In *Hall v. Union Light, Heat & Power Company* (1944) 53 F. Supp. 817 at page 818 the court said:

“The Act uses the language that they shall be considered as having been on furlough or leave of absence during the period of training and service.”

And the Supreme Court of the United States in *Fishgold v. Sullivan Drydock and Repair Corporation* (1946) 328 U.S. 275, 90 L. ed. 1230 at page 1240, stated:

“He shall be ‘restored without loss of seniority’ and be considered ‘as having been on furlough or leave of absence’ during the period of his service for his country, with all of the insurance and other benefits accruing to employees on furlough or leave of absence.”

It is thus to be seen that it has been repeatedly held that the words “pursuant to established rules and practices relating to employees on furlough or leave of absence” are not without significance in the Act, yet the holding of the trial court in the case at bar accords to those words no significance whatsoever.

When the courts were first confronted with the task of construing the Selective Training and Service Act of 1940, there was, it is true, a diversity among the lower courts as to whether the returning veteran was to be accorded a “super-seniority,” that is, seniority greater than that of the non-veteran employees having at the time of the veteran’s induction the same or higher seniority. This problem has twice been before the United States Supreme Court and in each case that court held that, though a veteran does not lose in relative seniority by reason of his absence in military service, neither does he gain in relative seniority by reason of that service. The first case was *Fishgold v. Sullivan Drydock and Repair Corporation* (1946) 328 U.S. 275, 90 L. ed. 1230. In that case the petitioner was a veteran who, upon application, had

been reinstated in the employ of the company after his return from service. Because of an insufficiency of work to be done, petitioner was laid off on nine separate days, although non-veterans, having a higher seniority than petitioner, were retained. Petitioner thereupon sued to obtain compensation for those days upon which he was not permitted to work. In denying the petitioner's claim, the court said at 90 L. ed. 1240:

"* * * We would distort the language of these provisions if we read it as granting the veteran an increase in seniority over what he would have had if he had never entered the Armed Services * * * No step-up or gain in priority can be fairly implied. Congress protected the veteran against loss of ground or demotion on his return. The provisions for restoration without loss of seniority to his old position or to a position of like seniority mean no more."

And at 90 L. ed. 1242 the court spoke as follows:

"Congress recognized in the Act the existence of seniority systems and seniority rights. It fought to preserve the veterans' rights under those systems and to protect him against loss under them by reason of his absence. There is indeed no suggestion that Congress sought to sweep aside the seniority system. What is undertaken to do was to give the veteran protection within the framework of the seniority system plus a guarantee against demotion or termination of the employment relationship without cause for a year."

The opinion in *Fishgold v. Sullivan Drydock and Repair Corporation* hence clearly repudiates the idea that the rights of a returning veteran are to be de-

terminated without reference to the seniority system already existent in the place of his employment. Rather are his rights established in reference to, and within the framework of, that seniority system.

The second case before the United States Supreme Court involving the doctrine of "super-seniority" was *Trailmobile Company v. Whirls* (1947) 331 U.S. 40, 91 L. ed. 939. That case began as a suit by an employee to enjoin a change in the seniority status allegedly accorded to him by the Selective Training and Service Act. It appears that the Trailmobile Company and the Highland Body Manufacturing Company, a wholly owned subsidiary of the Trailmobile Company, consolidated on January 1, 1944, and by agreement between the certified bargaining agent of the employees and the Trailmobile Company, as the continuing employer, the seniority of all the employees of the Highland employees was to recommence as of the date of consolidation. Whirls, who returned from service in May, 1943, claimed, however, that the Selective Training and Service Act barred the company from changing his relative seniority status, despite the collective bargaining agreement entered into by it with the bargaining representative of the employees. It was his contention that upon re-employment he was entitled to retain indefinitely his prewar plus service-accumulated seniority. In again denying to a veteran a "super-seniority," which he claimed, the Supreme Court said at 91 L. ed. 949:

"* * * If this extraordinary statutory security were to be extended beyond the statutory year, the restored veteran would acquire not simply

equality with non-veteran employees having identical status as of the time he returned to work. He would acquire indefinite statutory priority over non-veteran employees, a preferred status which we think not only inharmonious with the basic Fishgold rationalization, but beyond the protection contemplated by Congress."

At 91 L. ed. 950 the court said:

"Whirls was treated exactly as were other employees in his group having the same seniority and status as he had on the date of his re-employment. There was no discrimination against him as a veteran or otherwise than as a member of that group. Both groups, the former Trailmobile employees and the former Highland employer, who compared his group, contained veterans and non-veterans in large numbers. Both contained veterans in active service and re-employed veterans when the collective agreement was made. Whirls was treated exactly as all other members of his group, the ex-Highland employees, veterans and non-veterans alike."

In light of the fact that the Supreme Court has twice committed itself to the doctrine that the returning veteran has not been accorded "super-seniority" by Congress, it must be taken, as established, that in order to comply with the Selective Training and Service Act of 1940, an employer must not discriminate against the returned veterans in his employ; but—he is under no obligation to discriminate in *favor* of those veterans. The employer's obligation is but an obligation to accord the identical treatment to veterans as accorded by him to non-veterans. In the words of the statute, the returning veteran is "entitled to partici-

pate in insurance or other benefits offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence in effect with the employer at the time such person was inducted into such forces." The Congress made the right of the returning veteran dependent upon his rights as of the time of his induction. To determine the rights of a veteran upon his return to employment, one must hence first determine the "established rules and practices relating to employees on furlough or leave of absence" in effect at the time of his induction.

II.

Under the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time of induction of each claimant, the time spent by any employee of the Seattle Star in the armed forces was not to be included in the computation of severance pay for that employee.

The plaintiff John Randolph was inducted into the Armed Forces of the United States in January, 1942 (R. 16). The plaintiff Philip W. Taylor was inducted into the Armed Forces of the United States in the month of August, 1942 (R. 18). From October 5, 1940 to October 4, 1942, there was in effect a contract between the Seattle Star and the Seattle Newspaper Guild, Local 82, of the American Newspaper Guild, affiliated with the Congress of Industrial Organizations (R. 17).

Sec. 4 and Sec. 5 of Article VIII (R. 22) of that contract provide as follows:

"4. In computing severance pay the length of

service of the employee shall be the total years of full time continuous employment in the Scripps League.

“5. By written agreement with the Publisher, employees may be granted leaves of absence without prejudice to continuing service in the determination of severance pay, but time spent on such leave shall not count as service time.”

The quoted sections make clear the fact that severance pay is dependent upon the total years of full time continuous employment and — that time spent upon leave of absence is *not* to be counted in the computation of the period of full time continuous employment. Had a non-veteran employee entered the employ of the Seattle Star on January 1, 1940, worked continuously until January 1, 1944, taken a leave of absence until January 1, 1946, and then resumed full time work until the time of his severance on August 13, 1947, it is clear that his two years on leave of absence would not have been counted in the computation of his period of employment for severance pay purposes. The contract between the Guild and the Star can be read in no other way. There is within it no latent ambiguity requiring, or permitting, judicial construction. The contract states:

“* * * Employees may be granted leaves of absence * * * but time spent on such leave(s) shall not count as service time.”

The words are simple; their meaning clear. Because of them a non-veteran could not possibly claim that time spent by him on leave of absence should be

counted in the computation of his full time service for severance pay.

The parties to the Newspaper Guild - Seattle Star contract anticipated leaves of absence on the part of employees, and that contract stipulated the exact effect that such leaves of absence were to have upon the computation of severance pay. Certainly the provisions of that contract became the "established rules" as regards severance pay upon its execution by the contracting parties.

It follows, we submit, that a returning veteran is in no more favored position to claim that his "time in service" should be counted in the computation of severance pay than is a non-veteran to claim that his "time on leave of absence" should be so counted. The contract bars not only the non-veteran; but, by virtue of the Selective Training and Service Act, it likewise bars the veteran. Permitting the veteran to count his "time in service" towards severance pay but forbidding the non-veteran to count his "time on leave of absence" would be according to the veteran the very "super-seniority" which has been twice condemned by the United States Supreme Court.

The provisions of the Newspaper Guild - Seattle Star contract do not offend the provisions of Title 50 U.S.C.A. App. Sec. 308(c). On the contrary, they set out the very "benefits offered by the employer" and establish the very "rules and practices relating to employees on furlough or leave of absence" of which the statute speaks.

We have been unable to find among the reported cases any in which the precise point here at issue has been presented, but a decision which lends strong support to the appellant in the case at bar was rendered by the United States Circuit Court of Appeals for the Third Circuit in the case of *Gauweiler v. Elastic Stop Nut Corporation of America* (1947) 162 F.(2d) 448. In that case the plaintiff was a returned veteran. During his absence in the Armed Forces, a new contract was negotiated by the employer and the authorized bargaining agent for its employees. Under the terms of that contract, union officials became entitled to a higher seniority than employees who were not such officials. After his reemployment, the veteran was laid off during a period of slack work but a union official, having less seniority in point of service with the employer, was retained. To this the veteran objected and filed an action for loss of wages and for a declaration of reemployment rights under the Selective Training and Service Act.

In holding that the employer had not acted in contravention of the Selective Training and Service Act, the court said at 162 F.(2d) 451:

"All this (the statements of the Supreme Court in the *Fishgold* and *Trailmobile* cases) mean, we think, that what the Act gives to the veteran is the right not to lose his position or seniority by virtue of his absence in military or naval service. He is protected while away to the same extent as if he had been either continuously on the job in the plant or away on furlough or leave of absence for some personal reason.

"Let us consider briefly what our employee's

seniority rights would have been, had he remained continuously employed in the plant, without having been called away to war service. He would, of course, have had his rights fixed as to seniority, working conditions, pay, and the rest, by terms of the contract entered into between the recognized bargaining agent and the employer * * *.

"It is to be emphasized that in our case there is no suggestion of discrimination against veteran employees. The significance of that point was mentioned by the Supreme Court in the *Trailmobile* case, 67 S. Ct. 982 at page 991. Discrimination would obviously change the whole picture. If during the absence of some of the employees at war, those remaining got together and created union offices for themselves so that everyone had an office, and then proceeded to provide top seniority for union offices, a court would have no trouble in seeing that this device was simply an effort to discriminate against absentee fighting men. No such point is involved in the problem before us * * *.

"The considerations above stated bring us to the conclusion that the employee absent in war service is bound by the non-discriminatory arrangement made between the bargaining unit and the employer during his absence. This fits precisely with the concept of rights under the statute enunciated by the Supreme Court in *Fishgold* and reiterated in *Trailmobile*. The veteran does not lose by his absence. He simply remains as if he were on the job and subject to the well established and accepted routine of collective bargaining, so far as this particular right of seniority is concerned."

Certainly if a veteran is bound by non-discriminatory contractual provisions entered into by his bargaining representative and his employer during his absence in the armed service, he is *a fortiori* bound by such non-discriminatory provisions already in effect, as in the case at bar, prior to his induction. The "leave of absence" provision in Article VIII of the Newspaper Guild-Seattle Star contract was manifestly non-discriminatory and, being so, it must be deemed to be controlling in this controversy.

We submit that not only by the plain words of Congress but by the authority of the decided cases, the appellees are barred from counting their "time in service" in the computation of severance pay.

III.

The rights given to a reemployed veteran by Title 50 U.S.C.A. App. Sec. 308 (Selective Training and Service Act of 1940) are limited in time, and in the instant case expired prior to the termination of employment of the appellees.

From the foregoing it is clear that if the returning veteran has been given rights equal to, but no greater than, the rights of a non-veteran of like seniority, the present claimants cannot count their "time in service" in the computation of severance pay. If it be held by this court, however, that a returning veteran has the right not only to equal, but to greater, privileges than a non-veteran of like seniority, then we submit that such "super-seniority" terminates at the expiration of one year after his return. Such was the holding of the Supreme Court in *Trailmobile Com-*

pany v. Whirls, supra. In that case the plaintiff, a veteran, returned from service in May, 1943. Thereafter, as had already been set forth in this brief, his former employer, the Highland Body Manufacturing Company, was consolidated with the Trailmobile Company. An agreement was then entered into by the Trailmobile Company and the authorized bargaining representative of the employees, and this agreement provided that the seniority of all former Highland employees should commence as of January 1, 1944, the date of consolidation, regardless of the dates of their original employment by Highland. On or about September 3, 1945, Whirls was transferred from the painting to the stock department and the company threatened to reduce his pay from \$1.05 to 83c per hour. Whirls then brought a suit to enjoin that threatened decrease in pay and change in seniority status. The United States Supreme Court specifically confined its attention to the consideration of but one question, that question being framed by the court at 91 L.ed. 945 as follows:

“We turn therefore to consideration of the sole question presented on the merits, namely whether under Sec. 8 the veteran’s right to statutory seniority extends indefinitely beyond the expiration of the first year of his reemployment, being unaffected by that event as long as the employment itself continues.”

The Government on behalf of the plaintiff Whirls, contended that, whereas the statutory security against discharge terminated at the end of one year, the statutory protection of the “other rights” of a veteran

continued for the life of the job itself. The court however held against this contention of the Government and said at 91 L.ed. 948:

“It is therefore clear that Congress did not confer the rights given as incidents of the restoration simply to leave the employer free to nullify them at will, once he had made it. Equally clearly Congress did not create them to be operative for the vaguely indefinite and variously applicable period of a reasonable time. But we cannot agree that they were given to last as long as the employment continues, unaffected by the expiration of the one year period.”

At 91 L.ed. 949 the court went on to state:

“For the statutory year indeed this meant that the restored rights could not be altered adversely by the usual processes of collective bargaining or of the employer’s administration of general business policy. But if this extraordinary statutory security were to be extended beyond the statutory year, the restored veteran would acquire not simply equality with non-veteran employees having identical status as of the time he returned to work. He would acquire indefinite statutory priority over non-veteran employees, a preferred status which we think not only inharmonious with the basic Fishgold rationalization but beyond the protection contemplated by Congress.”

And finally at 91 L.ed. 950 the court said:

“The only question here and the only one we decide is that Sec. 8(c) although giving the re-employed veteran a special statutory standing in relation to ‘other rights,’ as defined in the

Fishgold case, during the statutory year, and creating to that extent a preference for him over non-veterans, did not extend that preference for a longer time * * *.

* * * * *

“We find it unnecessary therefore to pass upon petitioner’s position in this case, namely, that all protection afforded by virtue of Sec. 8(c) terminates with the ending of the specified year. We hold only that so much of it ends then as would give the reemployed veteran a preferred standing over employees not veterans having identical seniority rights as of the time of his restoration. We expressly reserve the decision upon whether the statutory security extends beyond the one year period to secure the reemployed veteran against impairment in any respect of equality with such a fellow worker.”

The court thus makes it clear beyond argument that the expiration of one year after reemployment terminates any *preferred* standing which a returning veteran may have over a non-veteran of identical seniority. After that time, they resume a position of absolute equality.

In the case at bar, it has been shown that a non-veteran employee of the Seattle Star could not count time on leave in the computation of his severance pay. If the claimants then are permitted to count their “time in service” in the computation of severance pay, that privilege would have to be based upon a preferential standing accorded to them by the Selective Training and Service Act of 1940. Though we deny that claimants ever had such a preferential

position as regards severance pay, we submit that their preferential position, if any ever existed, did not extend beyond the expiration of one year after reemployment.

Claimant Randolph reentered the employment of the Seattle Star on January 14, 1946 (R. 4); on August 13, 1947, his employment was terminated. Claimant Taylor reentered the employment of the Seattle Star on February 8, 1946 (R. 8); on August 13, 1947, his employment was terminated. At their time of severance from employment with the Seattle Star, neither of the claimants was hence within the first year of his reemployment. We submit therefore that even if the Selective Training and Service Act of 1940 accorded to claimants a preferential standing over non-veterans, that preferential standing had terminated long before their final severance of employment and that in computing the severance pay of the claimants, no distinction should, nor legally can, be made between them and non-veterans.

CONCLUSION

We respectfully submit that the trial court was in error in its application of the law to the facts, as stipulated, and that in consequence the judgment of the trial court should be reversed.

Respectfully submitted,

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E. L. SKEEL, Liquidating Trustee,
Appellants,
vs.

JOHN RANDOLPH and
PHILIP W. TAYLOR,
Appellees.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
STATES, FOR THE WESTERN DISTRICT OF WASHINGTON,
NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEES

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IN THE
United States
Circuit Court of Appeals
FOR THE NINTH CIRCUIT

SEATTLE STAR, a corporation, and
E. L. SKEEL, Liquidating Trustee,
Appellants,

vs.

JOHN RANDOLPH and
PHILIP W. TAYLOR,
Appellees.

UPON APPEAL FROM THE DISTRICT COURT OF THE UNITED
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HONORABLE JOHN C. BOWEN, *Judge*

BRIEF OF APPELLEES

STATEMENT

The petition in this case, in two separate causes of action (R 2-10) was filed by appellees in the District Court September 4, 1947 (R 11) — not for the purpose of securing their old jobs back, because these, with proper seniority rights had already been re-

stored, but wholly and solely for the purpose of enforcing other rights vouchsafed to them by the provisions of the Selective Training and Service Act (Sec. 308 T. 50 App. U.S.C.) “*to specifically require such employer to comply with such provisions.*”

The statute, Sec. 308 (c) Title 50 App. U.S.C.A. provides:

“Any person who is restored to a position in accordance with the provisions of paragraph (* * * (B)) of subdivision (b) shall be considered as having been on furlough or leave of absence during his period of active military service, shall be so restored without loss of seniority, *shall be entitled to participate in insurance or other benefits* offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence *in effect with the employer at the time such person was inducted into such service*, and shall not be discharged from such position without cause within one year after such restoration.” (Italics ours.)

Section 308(e) reads:

“In case any private employer fails or refuses to comply with the provisions of subdivision (b) or *sub-section (c)*, the District Court of the United States for the district in which such private employer maintains a place of business shall have power, upon the filing of a motion, petition or other appropriate pleading by the person entitled to the benefits of such provisions, *to specifically require such employer to comply with such provisions*, and, as an incident thereto, to compensate such person for any loss of wages or bene-

fits, suffered by reason of such employer's unlawful action * * *." (Italics ours.)

Thus, the veteran was not only assured of his old job back without loss of seniority, but likewise the Congress assured him that he would "*be entitled to participate in insurance or other benefits offered by the employer,*" one of which was, of course, severance pay based upon his length of service in accordance with the provisions of the severance pay schedule set out at p. 9 hereof. And, because of his military service, insofar as his job was concerned, he was to be considered "on furlough" during his military service, which has been construed by the courts to mean "in the service of his employer at the plant."

The essential facts were stipulated (R 15) and after full argument the trial court made the following oral decision (R 30-32):

"THE COURT: This statute of Congress, Title 50, Section 308 Appendix, was a humane measure for the protection of the soldiers and sailors and others in the military service in respect to their employment while they were absent in the military service. The public policy therein expressed must of necessity have a liberal construction. If we admit in this case that there is a conflict between the union contract of employment relating to all employees of the Seattle Star and this statute, it seems to me that the policy of the statute must be upheld to the exclusion of the conflicting provisions of the agreement be-

tween the union, allegedly representing these employees, and the employer, the Seattle Star.

“The conflict between the statute and the work contract would be more explicit if, instead of ‘other benefits’, the statute in subsection (c) had said ‘severance pay’. But the statutory provision that ‘returned soldiers shall be entitled to participate in insurance or other benefits offered by the employer’ (in effect to the other employees) certainly includes severance pay. It is all-inclusive. And if we fail to apply in favor of these veterans the same statutory treatment as to severance pay which was accorded the other employees, then these returned soldiers — veterans of the second world war — are not participating, as they are entitled to under the statute, in such other benefits including severance pay.

“If it could be said, *arguendo*, that some doubt is thrown upon the meaning of the statute as applied to the kind of benefit here involved—namely, severance pay benefit — by reason of the fact that that benefit was not mentioned by the statute expressly but was expressly mentioned in the work contract wherein such benefit was excluded by paragraph 5, then such doubt should be by the Court resolved in favor of the veteran, under the rule requiring liberal interpretation of a statute for the relief of veterans.

“However, I do not see how it is possible for these plaintiffs, who are war veterans, to enjoy the other benefits offered by the employer to other employees if the plaintiffs are denied this particular benefit of severance pay secured to them by the statute on a parity with other employees who were continuously on active duty with the employer during the period of time that the plaintiffs were in the war service. It seems clear to the Court that to give effect to the con-

tract provision that time spent by plaintiff veterans on military leave should not be included in the computation of their severance pay would clearly be in conflict with the Act of Congress which provides that these veterans upon return from active service with the military forces shall have the other benefits enjoyed by these employees who did not go into the service.

“For the reasons stated by the Court, the Court finds, concludes and decides in favor of the plaintiffs for the amounts respectively alleged in the complaint.”

Based upon this oral decision, findings of fact, conclusions of law and judgment were duly entered on September 19, 1947 (R 32-40) from which this appeal is prosecuted.

In the Court's oral decision, reference, it will be noted, is made to paragraph 5. That paragraph refers to Article VIII of the Union contract in effect October 5, 1940, to October 4, 1942, which is Ex. B. (R. 20-22). Paragraph 5 reads:

“5. By *written agreement* with the Publisher, employees may be granted leaves of absence without prejudice to continuing service in the determination of severance pay, *but time spent on such leave shall not count as service time.*” (R. 22) (Italics ours.)

Of course, there is no contention here by appellants, as we understand it, that there was any written agreement between the Star and these veterans with

respect to the military leave of appellees, and even had there been and it embodied the provisions of this paragraph 5 it would be clearly against public policy in the circumstances, because Congress had already declared the public policy, in the enactment of the Selective Training and Service Act.

Clearly paragraph 1 of Article X — Military Service, Ex. B. (R. 23) insofar as it provides that “such leave may be deducted in computing severance pay” (in effect October 5, 1940 to October 4, 1942) is in direct conflict with the amended Act of September 16, 1940, c. 720, Sec. 8, 54 Stat. 890 (Sec. 308c, Title 50 App. U.S.C.) and apparently was so recognized by the Union and the appellant Seattle Star, because we find in the new contract, Ex. C. (R. 24-28), this provision completely eliminated, and Article X. — Military Service, in effect on and after January 1, 1946, brought into conformity with the provisions of the Selective Training and Service Act.

This change was made, by mutual agreement while appellees were in military service.

ARGUMENT

At the outset we call attention to the two documents in the record labeled “Appellants’ Designation

of Points To Be Relied Upon On Appeal" (R. 44 and R. 48).

That set out at R. 44 contains but two points and was timely filed under the rule (Rule 75d) but that set out at R. 48 contains a third point which was never presented to nor considered by the trial court, was never filed with the Clerk of the District Court within the time limited by the Rule or at all, but was filed with the Clerk of this Court long after the time had expired for the filing of the record in this court, and therefore cannot now be considered because of its being first raised on appeal.

Jones v. United States, 179 F. 584.

The statute under which this proceeding was initiated is the veteran's re-employment provisions of the Selective Training and Service Act of 1940 as amended (Title 50 U.S.C.A. App. Sec. 301, et seq.) which, by Section 308(b), provides:

"In the case of any such person who, in order to perform such training and service, has left or leaves a position, other than a temporary position, in the employ of any employer and who (1) receives such certificate, (2) is still qualified to perform the duties of such position, and (3) makes application for re-employment within ninety days after he is relieved from such training and service or from hospitalization continuing after discharge for a period of not more than one year —

* * *

“(B) if such position was in the employ of a private employer, such employer shall restore such person to such position or to a position of like seniority, status, and pay unless the employer’s circumstances have so changed as to make it impossible or unreasonable to do so; * * *”

With this provision of the law appellant Seattle Star fully complied. In restoring appellees to their former positions it gave appellees the benefit of the Union contract graduated wage increase based entirely upon “years of service” including therein, in its calculation, the time appellees were in actual military service (and not working at the plant). In the case of appellee Randolph it was slightly over four years (January 9, 1942 - January 14, 1946), (R. 16-17), and in the case of appellee Taylor, it was approximately 3½ years (August 20, 1942 - February 5, 1946) (R. 18-19), but appellants refused to recognize this same principle with respect to severance pay when, on August 13, 1947, the Seattle Star sold out, discharged all of its employees, and commenced voluntary liquidation proceedings (R. 16).

After commencing liquidation proceedings wherein appellant Skeel was named the Liquidating Trustee, and in paying off the discharged employees of the Star insofar as veterans were concerned, appellants refused to include the time these veterans served in the military service in computing severance pay, but

did pay non-veterans severance pay (R. 19) in accordance with the severance pay schedule, which follows (R-24):

ARTICLE VIII SEVERANCE

* * *

2. Upon dismissal, any employee covered by this contract shall receive a cash severance pay in a lump sum in accordance with the following schedule:

Six months and less than one year.....	2 weeks
One year and less than two years.....	3 weeks
Two years and less than two and one-half years	4 weeks
Two and one-half years and less than three years	5 weeks
Three years and less than three and one-half years	6 weeks
Three and one-half and less than four years	7 weeks
Four years and less than four and one-half years	8 weeks
Four and one-half and less than five years	9 weeks
Five years and less than five and one-half years	10 weeks
Five and one-half and less than six years	11 weeks
Six years and less than six and one-half years	12 weeks
Six and one-half years and less than seven years	13 weeks
Seven years and less than seven and one-half years	14 weeks
Seven and one-half years and less than eight years	15 weeks
Eight years and less than eight and one-	

half years	16 weeks
Eight and one-half years and less than nine years	17 weeks
Nine years and less than nine and one- half years	18 weeks
Nine and one-half years and less than ten years	19 weeks
Ten years and less than ten and one-half years	20 weeks
Ten and one-half years and less than eleven years	21 weeks
Eleven years and less than eleven and one-half years	22 weeks
Eleven and one-half years and less than twelve years	24 weeks
Twelve years and less than twelve and one-half years	26 weeks
Twelve and one-half years and over....	28 weeks

The rule is well settled that “collective bargaining agreements” which come into conflict with the provisions of the Selective Training and Service Act (subsection c. Sec. 308, Title 50 App. U.S.C.) must yield thereto.

Lord Mfg. Co. v. Nemenz (D.C. Pa. 1946), 65 F. Supp. 711;

Trailmobile Co. v. Whirls (C.C.A. Ohio 1946), 154 F. (2d) 866 (reversed on other grounds, 331 U.S. 40, 91 L.Ed. 939).

The trial court was right in awarding judgment in favor of appellees and it is respectfully submitted that the judgment should be affirmed.

ARGUMENT IN ANSWER TO APPELLANTS SUMMARY OF ARGUMENT

The gist of appellants' contention is that because Union contract between appellant Seattle Star and the bargaining agents of its employees (The Seattle Newspaper Guild) provided that (1) *time on leave of absence* should not be included in computing severance pay, (2) that *time spent in the Armed Forces* should likewise not be included in the computation of severance pay, and (3) that appellees lost their preferential position upon the termination of the *first year* of their re-employment, and that as a result, they must be treated no differently from the non-veterans in the computation of severance pay. This third point was not raised below and comes too late.

In its last analysis, the contention plainly is that appellees *merely* "took a vacation." *They did no such thing.*

The service they so patriotically performed for their country was *anything but* a vacation!

Nor can it be successfully argued that they or either of them were given a "preferential position" upon their return. The fact is that the "stay-at-homes" are the ones who were given a preference, and

the veteran by reason of this preference to the "stay-at-home" was grossly discriminated against, contrary to law.

We will deal with appellants' argument in the order presented in the brief.

First, it is argued that under Title 50 App, U. S. C. Sec. 308, the rights of each claimant to employment benefits were determined by the contract in effect between the Seattle Star and the Seattle Newspaper Guild at the time that appellees were inducted into the armed forces.

Of course this is not wholly true, because the statute is not predicated upon, nor did the Congress intend that a Union contract should fix the rights of persons called into the military service in time of war under the Selective Training and Service Act (T. 50 App. U.S.C. Sec. 301 et seq.) any more than the Government would have been required to secure the permission of the Union before Congress could make a declaration of war.

The premise is true only in the sense that it was by virtue of the Union contract that the employer adopted the severance-pay schedule, which was "*in effect with the employer at the time*" these appellees "*were inducted into such forces*" (Sec. 308c).

The statute says the veteran "shall be entitled to participate in insurance or other benefits offered by the employer pursuant to established rules and practices relating to *employees on furlough* or leave of absence * * *." Insofar as the contract undertook to modify the plain provisions of the statute, it is clearly against public policy, and, therefore, void.

The Union contract, in paragraph 5 of Article VIII (R. 22), provides that "*time spent on such leave shall not count as service time,*" but an examination of the paragraph should convince anyone that the leave referred to therein is leave *voluntarily granted by the employer* which must be "by written agreement" as distinguished from *involuntary leave* of the employee by virtue of being drafted into the Armed Forces of the United States, in accordance with the statute. To argue that permission of the employer to his employee for leave to enter the military service in the defense of his country must be had under any circumstances is too absurd to merit serious attention.

In apparent realization of the attitude of some employers on this score, the Congress, cognizant of conditions extant after World War I and the plight in which the veterans of that war found themselves after being mustered out, enacted this humane legislation to prevent a recurrence of the shameful spec-

tacle of men who had so valiantly fought for their country, after being mustered out, being required to stand on street corners selling pencils and apples in order to eke out an existence, to assure those entering military service in the Second World War that they would be protected in this regard by their Government.

It is true that in the Union contract in effect prior to the time these appellees left their respective positions with the Star to enter the military service was the unconscionable provision which penalized such employees for entering military service by the tenth Article thereof (R. 23) which authorized a leave of absence "to serve in the Armed Forces of the United States * * * with severance-pay rating and other rights unimpaired *except that such leave may be deducted in computing severance pay.*"

However, before appellees commenced their service in the Army, and in January, 1941, this italicized provision was deleted and the new Article X was substituted and appears in the printed contract bearing date of January 1, 1946 (R. 26.7). For convenience we are setting it out herein. It reads:

"An employee who is required by the United States or any subsidiary thereof to enter any kind of service, military or otherwise, which takes him out of the employment of the Publisher, or

who, while the United States is at war, voluntarily enters into any of the military armed services of the United States, or who is released from his job as a result of any government order or ruling, shall be deemed an employee on leave of absence, and shall resume his position or a comparable one within two (2) weeks from date of his notice of desire to resume employment, *with dismissal pay rating and other rights unimpaired.*
* * *

So that, before the appellees left their employ with the Star and before they returned from their military service there was no provision in the Union contract providing that military leave should be deducted in computing severance pay.

The leave of absence provision is paragraph 6 of Article VIII (R. 25).

The language of the statute (Sec. 308c) is:

“Any person who is restored to a position in accordance with the provisions of * * * (B) of subsection (b) *shall be considered as having been on furlough or leave of absence during his period of military service.*” (Italics ours.)

This is a declaration by the Congress that time spent in the armed forces shall be considered as time in service of the employer, but without pay from the former employer during such time, while paragraph 6 of Art. VIII of the Contract can only have reference to the kind of leave covered by “written agreement with the Publisher.”

Appellee Randolph first entered appellant Seattle Star's employ in 1936. He became a reporter two years later. He left that employment in 1942 and served in the Army until 1946. He had worked for the Star nearly six years before answering the call of his country, four years of that as a reporter. When he was re-employed by the Star in 1946 he was classified as a sixth year reporter and was paid a salary of \$65 per week (R. 17).

When he was discharged from his employment in August, 1947, he was receiving a weekly salary of \$73.50.

In other words, appellants recognized for the purpose of seniority and wages, a *full-time continuous service*, but nevertheless refused to recognize appellees four years' military service as full-time continuous service in computing severance pay.

The same is true as to appellee Taylor.

This same section of the statute provides that the veteran shall be so restored "without loss of seniority, *shall be entitled to participate in insurance on other benefits offered by the employers * * *.*"

Counsel at p. 7 of their brief say:

"It is manifest therefore that one can determine the benefits to which a returning veteran

is entitled only by determining the benefits to which he would have been entitled *had he not been inducted into the Armed Forces* but rather had taken a furlough or leave of absence."

This is the crux of the case as made by appellants, and had Congress and the Courts not spoken on the subject there might be some room for argument in the position they take. But the Congress has spoken and the courts — many of them — have construed this statute.

For instance, in the Fishgold case (328 U.S. 275), Mr. Justice Douglas said:

"This legislation is to be literally construed for the benefit of those who left private life to serve their country in its hour of greatest need. See *Boone v. Lightner*, 319 U.S. 561, 575, 63 S. Ct., 1223, 1231, 87 L.Ed. 1587. *And no practice of employer or agreements between employers and Unions can cut down the service adjustment benefits which Congress has secured to the veteran under the Act.*" (Italics ours.)

In that same case, the Court further said:

"As we have said, these provisions guarantee the veteran against loss of position or loss of seniority by reason of his absence. He acquires not only the same seniority he had; *his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence.*" (Italics ours.)

Fishgold v. Sullivan Drydock & Rep. Corp.,
328 U.S. 275.

Counsel for appellants, commencing at page 9, cite, and quote from, Circuit Court cases as well as the Fishgold case, *supra*, on the question of "furlough and leave of absence" with all of which we agree, but the argument ignores the fact that at the time these appellees entered the military service that the feature of the Military Service provision of the Union contract contained in Article X (R. 23), which provided that military "*leave may be deducted in computing severance pay*" was eliminated therefrom as more fully appears by an examination of the new Article X appearing in the record at pp. 26 and 27.

The new Article X (p. 27) even further provides:

"To protect an employee granted military leave in the event that such employee by reason of death is unable to resume employment, the Publisher agrees that from January 2, 1944, the Publisher will pay \$1.00 per month towards the Government Insurance carried by such employee.

"This payment is sufficient to purchase, at current rates, \$1,500.00 Government Life Insurance and the disability provisions incidental thereto." (Ex. C).

There is involved in this case no question of so-called super-seniority, nor is there anything in the Supreme Court's opinion in the case of *Trailmobile Company v. Whirls*, 331 U.S. 40, 91, L.Ed. 939, that militates against the contentions here made.

In a case decided by the Circuit Court of Appeals for the Third Circuit and filed March 16, 1948 — *Joseph A. Mentzel v. Elizabeth Iron Works Company* (not yet in the Advance Sheets) — No. 9537, involving a very similar matter (vacation pay), the Court, speaking through Circuit Judge Gooderich, said:

“While the veteran was in the Army an association, of which the employer is a member, entered into a contract with the Union which was evidently the bargaining agent for the employee. This contract, of course, binds the employer and there is no suggestion that it does not. The point on which this case turns has to do with the language of Section 4(a) of that contract. It provides: “Employees shall receive vacations of one week with pay after one year’s service: vacations of two weeks with pay after five years of service. * * *”

“If Mentzel is entitled to count the period from the beginning of his employment with the Company, including the time he spent in the Army, as “service” he was entitled to two weeks vacation with pay in 1946. If he is not entitled to count the time spent in the Army as “service” with the employer under the terms of this contract, he has received, in his one week’s vacation with pay, all that he is entitled to. The latter is the position taken by the learned District Court and upon that basis he gave judgment for the defendant.

“The precise point seems to be new in this Circuit and elsewhere. But we think that the principle on which our own previously decided cases has been rested is sufficient to show what we think should be the answer here. In *Gauweiler*

v. Elastic Stop Nut Corporation, 16 2 F. (2d) 448 (C.C.A. 3, 1947), we examined the decisions of the Supreme Court in *Fishgold v. Sullivan Drydock & Repair Corp.*, 328 U.S. 275 (1946), and *Trailmobile Co. v. Whirls*, 331 U. S. 40 (1947). We concluded that the analysis of the Supreme Court meant "that what the Act gives to the veteran is the right not to lose his position or seniority by virtue of his absence in military or naval service. He is protected, while away, to the same extent as if he had been either continuously on the job in the plant or away on furlough or leave of absence for some personal reason." (p. 451). We held in that case that the veteran took subject to the contract made by the bargaining Union and the Company in his absence which had to do with seniority for Union officials. By the same token, quite clearly, the veteran is entitled to benefits accruing in his absence.

"Again, in *McLaughlin v. Union Switch and Signal Company*, — F. (2d) — (C.C.A. 3, February 9, 1948) we said: "* * * we can see no reason why the protection of the Selective Training and Service Act of 1940 in appropriate cases should not embrace vacation rights which the employee has earned and would have received as a matter of course but for his induction. * * * the statute was intended to place veterans on the precise point of the vacation escalator which they would have occupied had they kept their positions continuously during the war * * *."

"The statements quoted are not dicta, but enunciate the principle back of our decisions in the two cases cited. We thought then, and we think now, that the enunciation of the principle is in accordance with that given by the Supreme Court in the *Fishgold* and *Trailmobile* cases.

"The application here is simple. The veteran

is to be treated, so far as benefits under the Act are concerned, as though he had worked every day at the plant. He steps back on the escalator, when discharged from service, at the point where he would have been had he never donned the uniform. That being so, he is entitled to whatever vacation rights would have accrued to him had he not shouldered a gun and gone off to war. In this case, under the contract, it would have been two weeks for 1946. He was paid for one, he is entitled to be paid for the other.

"The judgment of the District Court will be reversed and the case remanded with directions to enter judgment for the plaintiff for the amount sued upon and costs."

On the second point argued by appellants, commencing at page 14 of the brief, stress is laid upon Sections 4 and 5 of Article VIII (R. 22) of the Union contract, saying:

"The quoted sections make clear the fact that severance pay is dependent upon the *total years of full-time continuous employment* and — that time spent on leave of absence is *not* to be counted in the computation of the period of full-time continuous employment."

We can only reiterate what we have already conceived to be the holding of the Supreme Court of the United States in the Fishgold case, *supra*, wherein the Court said:

"* * * his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence."

In any event, the rule is well settled that a Union contract cannot be used to "destroy and whittle down statutory right of returning Servicemen." *Trailmobile Co. et al v. Whirls*, 154 F. (2d) 866.

And a change in a Union contract during period of service of employee in armed service redounds to the benefit of the veteran. *Armstrong v. Tennessee Coal I. & R. Co.*, 73 F. Supp. 329.

It is stated by appellants (Br. p. 16) that the parties to the Newspaper Guild - Seattle Star contract anticipated leaves of absence on the part of employees and that the contract stipulated the exact effect such leaves would have, but the difficulty with the conclusion counsel draw from this fact is that the leaves of absence contemplated thereby are not the leaves of absence or "furlough" contemplated and provided for in the Selective Training and Service Act. The leave of absence provided for in the contract is the kind that is to be arranged by "written agreement" between the employer and employee as distinguished from the "furlough" Congress said the employer must grant to its employees called to the colors.

How counsel for appellants find any comfort in the third Circuit case of *Ganweiler v. Elastic Stop Nut Corporation of America* (1947), 162 F. (2d) 448,

is beyond one's comprehension, first, because it involves only a question of seniority rights with which we are not here concerned and, secondly, because that court, in its opinion, said, concerning the point on which we most strongly rely:

"It is to be emphasized that in our case *there is no suggestion of discrimination against veteran employees*. The significance of that point was mentioned by the Supreme Court in the Trailmobile case, 67 S.Ct. 982 at page 991. *Discrimination would obviously change the whole picture.*"

And that is precisely the point here. In the instant case appellants were guilty of "*discrimination against the veteran employees* in the matter of severance pay, in that they refused to accord them full severance pay while non-veterans were paid in accordance with the scale in effect at the time of discharge in August, 1947.

Therefore, the trial court was right on this point and its judgment should be affirmed.

On the third point raised in the brief, and which we have heretofore pointed out, was neither raised by the pleadings, called to the attention of the trial court nor argued below, is raised for the first time on this appeal and comes too late.

Jones v. United States (9 Cir.) 179 F. 504;

Marco v. United States (9 Cir.) 26 F. (2d) 315;

United States v. Domres, 142 F. (2d) 477.

Counsel for appellants on this point have built up a straw man on the theory of "super-seniority" and then proceed to knock him down on the one-year theory, based upon the decision of the United States Supreme Court in the Trailmobile case, which has not the slightest applicability here.

In the case at bar there is no question whatever of "super-seniority" but the simple matter of "benefits".

To argue that the veteran restored to his former position upon his discharge from the Army must be "discharged" within one year from the date of his re-employment in order to secure the full benefit of severance pay is, to say the least, a most unusual contention and one which borders on the ridiculous. Severance pay is calculated wholly and solely upon length of service ranging from six months to twelve years (R. 24-25) and, as we have already seen, military service under the Selective Training and Service Act, the United States Supreme Court has held, "*is counted as service in the plant so that he (the veteran) does not lose ground by reason of his absence.*" (328 U.S. 275).

So that, even if the question were properly raised, there is no merit in the contention.

The Act of Congress under which this proceeding was instituted in the District Court contemplates a speedy hearing and its advancement on the calendar. No specific provision is made in the Act for a review of the decision of the District Court.

A speedy hearing was had in the District Court. It has taken just seven months since the entry of the judgment below to get this case here for review. The judgment was entered in September, 1947, which leads us to believe that Congress did not intend to provide for appeals from judgments of this sort except perhaps on constitutional grounds.

So far as here pertinent, the statute (Sec. 308a) reads:

“* * * The court shall order a speedy hearing in any such case and shall advance it on the calendar.”

The petition was filed September 4, 1947 (R. 2). The answer, September 15, 1947 (R. 11). The hearing had the same day and findings of fact, conclusions of law and judgment entered September 19, 1947 (R. 32-38). The notice of appeal was filed December 16, 1947 (R. 41) and the specification filed the same day.

This, we submit, is not the speedy hearing contemplated by Congress and no constitutional question being raised on this appeal it is questionable if there is a right of appeal. We respectfully ask that this court assign this case for early hearing.

CONCLUSION

From the foregoing, the Court must conclude that there is no merit whatever in this appeal and the judgment of the District Court should be affirmed.

Respectfully submitted

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IN THE
UNITED STATES
CIRCUIT COURT OF APPEALS
FOR THE NINTH CIRCUIT

SEATTLE STAR, a corporation and E. L.
SKEEL, Liquidating Trustee, *Appellants*,
vs.

JOHN RANDOLPH and PHILIP W. TAYLOR,
Appellees.

UPON APPEAL FROM THE UNITED STATES DISTRICT
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NORTHERN DIVISION

HONORABLE JOHN C. BOWEN, *Judge*

REPLY BRIEF

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No. 11828

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REPLY BRIEF

I.

**THE FINAL JUDGMENT OF THE DISTRICT COURT
IS REVIEWABLE IN THIS COURT**

In their answering brief (B 25-26) appellees have argued that the judgment of the trial court is not appealable and hence is not properly reviewable by this court. The Selective Training and Service Act of 1940 requires that a speedy hearing be given to cases arising under its provisions. That requirement of speed does not thereby make the judgment upon that hearing a non-appealable order. Such a contention is indeed novel in light of the many decisions

under the Selective Training and Service Act of 1940, which have not only gone to the Circuit Courts of Appeal for review:

Feore v. North Shore Bus Company (1947)
161 F.(2d) 552;

Fishgold v. Sullivan Drydock and Repair Corporation (1946) 154 F.(2d) 785;

Gauweiler v. Elastic Stop Nut Corporation of America (1947) 162 F.(2d) 448;

Trailmobile Company v. Whirls (1946) 154 F.(2d) 866.

but to the United States Supreme Court as well:

Fishgold v. Sullivan Drydock and Repair Corporation (1946) 328 U.S. 275, 90 L. ed. 1230;

Trailmobile Company v. Whirls (1947) 331 U.S. 40, 91 L. ed. 939.

As stated in our opening brief (B. 2) appellant's reply upon specific statutory authority for this appeal. The judgment in the trial court was beyond doubt a "final decision" of a District Court, and by 28 U.S.C.A., Sec. 225, the Circuit Courts of Appeal have express jurisdiction to review such decisions.

II.

THE CONTRACT BETWEEN THE SEATTLE STAR AND THE NEWSPAPER GUILD DEFINES THE "ESTABLISHED RULES AND PRACTICES" CONTEMPLATED BY THE SELECTIVE TRAINING AND SERVICE ACT AND MUST NECESSARILY BE REFERRED TO IN DETERMINING THE RIGHTS ACCORDED A RETURNING VETERAN BY THE ACT

It is evident from statements made in their brief that appellees have misapprehended the basis of appellants' appeal.

In the first place, appellants do not rely upon the provisions of Article X of the contract between The Star and the Guild (R. 23) in force at the time appellees were inducted. Article X of the contract at the time appellees were inducted specifically provided that time spent on leave of absence was not to be counted in the computation of severance pay of veterans. Twice in their answering brief (B. 14 and 18) appellees indicate it is their belief that appellants place strong reliance upon Article X. An examination of appellants' opening brief will reveal that Article X was not only not relied upon, it was not so much as mentioned.

Attention is invited to incorrect statements of fact concerning Article X made by appellees. Twice in their brief (B. 14 and 18) appellees state that *prior* to the induction of appellees, Article X had been modified to eliminate the provision that time on leave of absence should not be counted in computing severance pay. That is incorrect. The stipulated facts were exactly the reverse (R. 18) they recite:

"No. 9. That Article X of the contracts between the Seattle Star and the Seattle Newspaper Guild in force from October 5, 1940 to January 2, 1944, was identical in form with Article X as it appears in Exhibit 'B' attached hereto. * * *"

Appellants do *not* rely upon Article X of the contract. Appellants rely on the provisions of Article VIII of the contract.

Appellees contend in their answering brief (B. 13) that Article VIII "undertook to modify the plain provisions of the statute" and that Article VIII is therefore void. This position, we submit, is demonstrably untenable.

The Selective Training and Service Act (Title 50, U.S.C.A., App., Sec. 308) assures the re-employed veteran of four specific things which we illustrate by subdividing the section as follows:

"(c) Any person who is restored to a position * * *, (1) shall be considered as having been on furlough or leave of absence during his period of training and service in the land or naval forces, (2) shall be so restored without loss of seniority, (3) shall be entitled to participate in insurance or other benefits offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence in effect with the employer at the time such person was inducted into such forces, and (4) shall not be discharged from such position without cause within one year after such restoration."

These words which we have designated as subdivision 3 of Section 308(c) above make it clear that Congress intended that returning veterans should get only those "other benefits" which non-veterans on leave of absence from the same employer would get. Congress established no absolute rights to "benefits." Whatever "benefits" veterans should get were all relative — relative to the "benefits" which non-veterans on leave of absence were entitled to receive. Therefore, in order to determine what "benefits" returning veterans were entitled to receive, we must first determine what "benefits" a non-veteran returning from leave of absence was entitled to receive. The plain words of the statute, as quoted above, certainly permit of only one mode of determining such rights or benefits, namely, the rules and practices relating to employees on furlough or leave of absence *in effect with the employer at the time such person was inducted.*

The provisions of Article VIII which established the "rules and practices relating to employees on furlough or leave of absence," were precisely the type of contractual provisions contemplated by Congress. The contract established the very "rule * * * relating to employees on furlough or leave of absence" contemplated as a prerequisite to the application of the Act. We submit that Article VIII did not, as claimed by appellees, "modify the plain provisions of the statute." It provided the required element, that is the "established rule" or "practice" necessary for the proper application of the Act.

Appellees argue in their answering brief (B. 13, 15, 22) that the provisions of Article VIII relating to leaves of absence can have no application to the claims of appellees because their leaves of absence resulted from involuntary absence due to being inducted into the Armed Service. It is contended that the provisions of Article VIII in this respect apply only in cases where a leave of absence is voluntary and the subject of a written agreement between the employer and the employee. We submit that subdivision 5 of Article VIII applies to all persons on leave of absence. By the terms of subsection 5, as it is written, an employer could refuse to agree in writing that an employee would be granted leave of absence without prejudice to continuing service in the determination of severance pay. With respect to a man inducted into the Armed Services, and even one who volunteered his services, Congress specifically directed that when that person was restored to a position in accordance with the provisions of the Selective Training and Service Act, he "shall be considered as having been on furlough or leave of absence during his period of active military service * * *." Congress saw fit to protect the veteran against the possibility of an employer being able to discriminate against him by refusing to give him a "written agreement" as contemplated by the contract. Congress, by the Act, actually extended the application of the paragraph in the contract to include involuntary leaves of absence resulting from induction into the Armed Services. It said in effect: any absence from employment for the pur-

pose of military service, whether voluntary or involuntary, establishes the status of leave of absence, written agreement or no written agreement.

The statute establishes the standard for determining what time counts in computing severance pay. It says that the right to the benefit of severance pay shall be in accordance with established rules and practices relating to employees on furlough or leave of absence in effect with the employer at such time as such person was inducted into such service.

As regards insurance and "other benefits," Congress provided that a returning veteran was to be treated in precisely the same manner as a non-veteran returning from a voluntary leave of absence. In compliance with that Congressional mandate the Seattle Star treated appellees as regards severance pay exactly as directed. We submit that the trial court was therefore in error in holding that the appellees should have received the same severance pay which they would have received had they been continuously in the employ of the Seattle Star.

Appellees place great reliance upon *Fishgold v. Sullivan Drydock & Repair Corporation* (1946) 328 U.S. 275, 90 L. ed. 1230, and quote the following language from the opinion in that case (B. 17, 21, and 24):

"He acquires not only the same seniority he had; his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence."

The Supreme Court had before it in the *Fishgold*

case the question of *seniority* not *benefits* (Title 50 U.S.C.A. App. 308), provides:

“(c) Any person who is restored to a position
* * * shall be restored without loss of seniority
* * *.”

The case at bar, involves the rights of returning veterans to benefit, other than seniority, and must be decided, not under the provisions relating to seniority, but under the provisions relating to “other benefits,” as follows (Title 50 U.S.C.A., App. 308):

“(c) Any person who is restored to a position
* * * shall be entitled to participate in insurance or other benefits offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence in effect with the employer at the time such person was inducted into such forces * * *.”

It is to be noted that as regards seniority Congress made no reference whatsoever to the “established rules and practices relating to employees on furlough or leave of absence” whereas the very heart of the provision relating to insurance and other benefits is that they are to be determined pursuant to those established rules and practices, in effect at the time of induction.

When, therefore, the Supreme Court spoke in the *Fishgold* case as follows (90 L. ed. 1240):

“He acquires not only the same seniority he had; his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence.”

it was speaking solely in reference to *seniority*, and

that language cannot now be taken from its context and construed to mean that *for all purposes* service in the armed forces is counted as service in the plant.

In the same vein appellees state (B. 16):

“In other words, appellants recognize for the purpose of seniority and wages, a full time continuous service, but nevertheless refuse to recognize appellees four years’ military service as full time continuous service in computing severance pay.”

The implication is that, by counting service time in computing seniority, appellants are estopped to deny that service time should be counted in the computation of severance pay. The practice adopted by appellants, however, was in recognition of the obvious distinction between the effect of service time as regards seniority and its effect as regards “other benefits.”

Appellees challenge (B. 23) the relevance of *Gauweiler v. Elastic Stop Nut Corporation of America* (1947) 162 F.(2d) 448, which was cited in our opening brief (B. 17). That challenge rests upon the assumption that Article VIII of the Star-Guild contract, was a provision discriminatory against veterans. As we have said, if that particular provision by its own terms applied only to employees of the Star who were not called into the services, it became applicable to the veteran employees also by virtue of the Selective Training and Service Act. Certainly under such circumstances it must be recognized that that clause was non-discriminatory, and, as such, was valid under the *Gauweiler* decision.

Appellees rely upon the case of *Mentzel v. Diamond d/b/a Elizabeth Iron Works Company* (C.C.A.-3, 1948)—F.(2d)—, 14 Labor Cases, Paragraph 64395. It was held in that case that the claimant was entitled to include his military service time as service with the employer in computing the vacation to which he was entitled. In that case, however, as expressly stated in the Findings of Fact of the lower court (—F. Supp.—, 13 Labor Cases Paragraph 63962):

“i. No evidence was presented of any rules or practices by the respondent governing the computation of the period of ‘service’ of employees.”

There was no clearly “established rule or practice” in the *Mentzel* case as regards inclusion or exclusion of time on leave of absence in the computation of vacation time. The union contract in that case provided:

“Employees shall receive vacations of one week with pay after one year’s service; vacations of two weeks with pay after five years of service.”

The Circuit Court in the *Mentzel* case decided merely that in the *absence of an established rule or practice relating to employees on leave of absence*, service time may be included in the computation of vacation time. The issue presented in the case at bar is the converse of the *Mentzel* issue. To sustain the decision of the trial court here, this court must decide that a veteran may include service time in the computation of severance pay *despite a clearly established rule and practice that an employee on leave of absence could not so count such time in the computation of his severance pay.*

We submit that the judgment in favor of the plaintiffs below was in direct conflict with the will of Congress as expressed in the Selective Training and Service Act of 1940.

III.

THE THIRD POINT IN APPELLANTS' OPENING BRIEF IS PROPERLY BEFORE THIS COURT DESPITE THE FACT THAT THAT PARTICULAR POINT WAS NOT INCLUDED IN THE APPELLANTS' ORIGINAL STATEMENT OF POINTS TO BE RELIED UPON ON APPEAL FILED IN THE DISTRICT COURT

The Federal Rules of Civil Procedure (Rule 75 (a)) require that the appellant serve upon the appellee and file with the District Court a designation of the portions of the record to be contained in the record on appeal.

Those rules further provide (Rule 75(d)) that if the complete record is not designated for inclusion in the record on appeal, the appellant must serve with his designation a concise statement of the points upon which he intends to rely on appeal. Appellants complied with those provisions.

Those provisions are, of course, to enable the appellee to designate those additional portions of the record which he feels would be necessary to him in meeting the points upon which the appellant has indicated his intention to rely. It would be obviously unfair to permit appellant to change the points upon which he intends to rely if the appellee in reliance on the statement of points furnished was thereby de-

prived of the opportunity to designate additional portions of the record material on appeal, but that is not the case here.

The rules of the United States Circuit Court of Appeals for the Ninth Circuit expressly provide, as follows:

“19. PRINTING RECORD. 6. The appellant shall, upon the filing of the record in this court, in all cases, including those on petition to review, to enforce or to set aside an order of a United States Board or Commission, *file with the clerk a concise statement of the points on which he intends to rely on the appeal*, and designate the part of the record which he thinks necessary for the consideration thereof, and forthwith serve on the adverse party a copy of such statement and designation. The adverse party, within ten days thereafter, may designate in writing, file with the clerk, additional parts of the record which he thinks material; and if he shall not do so, he shall be held to have consented to a hearing on the part designated.” (Italics ours)

In complying with this requirement of this court, appellants adopted the same designated portions of the record deemed necessary by them in their designations filed with the District Court but added one additional point to be relied upon on appeal to those specified in the District Court. Thereafter, appellees had ten days within which to designate additional portions of the record for consideration by this court, but they filed no further designation. As a matter of fact, it is clear that everything necessary for a complete and full determination of the third point

in appellants' brief is in the record on this appeal. That point involves the sole issue of the time of expiration of a returning veteran's right to benefits. The record reveals that both appellees had been re-employed for more than one year after their separation from the armed services. That fact is in and of itself sufficient to enable this court to consider appellants' additional point on appeal.

If appellees could show this court any prejudice to them because of the designation by appellants of this additional point—other than the intrinsic merit of the point itself—we should be happy to consent to its withdrawal from consideration. We submit that no such prejudice can be shown because (1) appellees were afforded an opportunity to designate additional portions of the record after appellants designated their additional point to be relied upon on appeal, and (2) the record before this court contains everything required for the full consideration of the point in question.

CONCLUSION

We respectfully submit that the trial court was in error in its application of the law to the facts, as stipulated, and that in consequence the judgment of the trial court should be reversed.

Respectfully submitted.

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No. 11828

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HONORABLE JOHN C. BOWEN, *Judge*

PETITION FOR REHEARING

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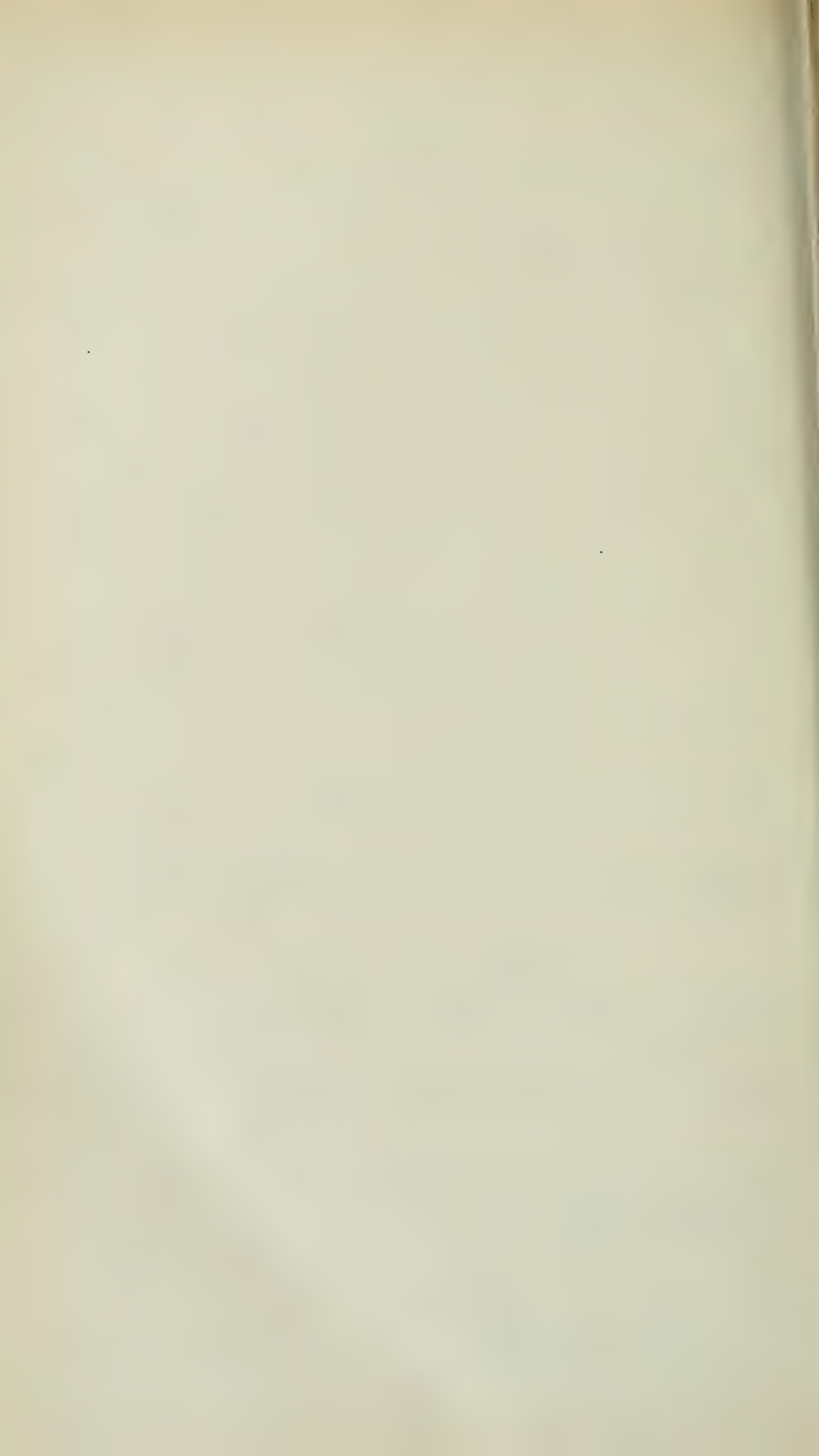
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PETITION FOR REHEARING

Under authority of Rule 25, Rules of the United States Circuit Court of Appeals for the Ninth Circuit, Appellees, by and through J. Charles Dennis, United States Attorney for the Western District of Washington, hereby respectfully petitions this Honorable Court for a rehearing in the above-entitled cause, the

judgment of reversal in which was filed in this court May 26, 1948.

The petition is filed for the following reasons, and upon the following grounds:

I.

On page 2 of the opinion it is said:

"Sec. 308(c) does not require that employers afford to returning veterans, *as distinguished from non-veterans*, any specific benefits in the nature of insurance or severance pay. It provides only for the participation by re-employed veterans in those insurance and other benefits 'offered by the employer pursuant to established rules and practices relating to employees on furlough or leave of absence in effect with the employer at the time such person was inducted into such forces'." (Italics ours.)

It was not intended to apply to anybody but veterans!

The Court then sets out Clauses 4 and 6 of Article VIII of the contract.

Clause 4 reads:

"In computing severance pay the length of service of the employee shall be the total years of full-time continuous employment by the Seattle Star."

The Court neither gives effect to nor even mentions the first two lines and a half of Clause 6 from which it quotes. That clause (section) reads:

"*By written agreement* with the publisher, employees may be granted leaves of absence without prejudice to continuing service in the determination of severance pay, but time spent on *such leave* shall not count as service time."

It is a strained construction to hold that the words "time spent on *such leave* (leave of absence) shall not count as service time" has anything whatever to do with any kind of a leave of absence save and except that accomplished by "*written agreement*" with the publisher, as so plainly set forth in the unambiguous language used.

Article X of the contract clearly supports this contention because it deals only with *military service* "which takes him out of the employment of the publisher."

That article deals exclusively with the subject matter of this litigation and the language used by the contracting parties is that such employee "*shall be granted a leave of absence * * * (Ex. B) with dismissal-pay rating* and other rights under the contract *unimpaired.*" (Ex. C)

This case deals with nothing but *dismissal-pay rating*, which the contract says in unmistakable language shall be "*unimpaired,*" by reason of the employee being required under the law to give up his job and shoulder a gun in the defense of his country.

In the case of *Fishgold v. Sullivan Drydock & Rep. Corp.*, 328 U.S. 275, the Supreme Court of the United States, speaking through Mr. Justice Douglas said:

“This legislation is to be liberally construed for the benefit of those who left private life to serve their country in its hour of greatest need. See *Boone v. Lightner*, 319 U.S. 561, 575, 63 S. Ct. 1223, 1231, 87 L.Ed. 1587. And no practice of employer or agreements between employers and unions can cut down the service adjustment benefits which Congress has secured to the veteran under the Act.”

and further

“As we have said, these provisions guarantee the veteran against loss of position or loss of seniority by reason of his absence. He acquires not only the seniority he had; *his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence.*” (Italics ours)

Had it been the intention of the parties to the union contract that clauses 4 and 6 of Article VIII were to control the provisions of Article X, we would expect to at least find some such indication therein. But there is no such indication to be gathered from any of the words used. On the contrary, a very clear indication is to be gathered from an examination of the original Article X contained in the contract in effect from October 5, 1940 to October 4, 1942 (Ex.

B), and the new Article X in the subsequent contract. It was first therein provided:

“The publisher agrees that all employees who leave their jobs to serve in the armed forces * * * shall be granted a leave of absence * * * that such employee (who leaves his job to serve in the armed forces) shall then (after his discharge from military service) be reinstated to the same or comparable position with severance-pay rating and other rights under this agreement unimpaired *except that such leave may be deducted in computing severance pay.*”

In the subsequent contract (Ex. C) the italicized words of the above-quoted Article X were completely eliminated, which is a clear indication of an intent on the part of the contracting parties to protect these veterans against *loss of severance pay* by reason of their enforced absence in the military service.

And this was done to bring the provisions of the contract into conformity with the Selective Training and Service Act.

The type of leave of absence provided for in Article VIII, paragraph 6, and in Article X of this union contract differ materially.

The leave of absence provided for in paragraph 6 of Article VIII (Exhibit C) referred to by the Court (which is paragraph 5 in Article VIII of the contract in effect October 1940 to October 1942, being Ex. B)

is a voluntary leave — *by written agreement* between the publisher and the employee — strictly for the convenience and pleasure of the employee and, quite properly, time spent on such leave should not be included in computing severance pay. *It applies only to the non-veteran.*

The leave of absence provided for in Article X of the union contract is not a voluntary leave — but an involuntary one. The article says in no uncertain terms that an employee who leaves his job “to serve in the Armed Forces of the United States * * * *shall be granted a leave of absence,*” and further provides that such leave shall be *with severance pay rating unimpaired.*” *And it applies only to the veteran.*

At page 3 of the opinion of this court it is said, after stating appellee’s contentions,

“However, an adjustment of appellee’s rights in accordance with the mandate of the law and the provisions of Article X of the contract which require time spent in the armed services to be considered furlough time, does not *impair* their severance-pay rights.”

The opinion (p. 3) goes on to state:

“It is argued that unless the contract be so interpreted as to permit appellees’ time in the Armed Services to be considered as full-time employment, said contract conflicts with Sec. 8(a) of the Selective Service and Training Act and is against public policy. Such a contention is dia-

metrically opposed to the plain reading of Sec. 8(c) and gives no effect to the requirement that the determination shall be made on the basis of the rules applicable at the time of induction to those on furlough or leave of absence."

The Court, by this language, has misconceived our position in this respect, because it ignores the fact that the rule as to *leave of absence for military service* was in effect at the time of induction of appellees. Our contention is that had the phrase "except that such leave may be deducted in computing severance pay" not been eliminated from the new Article X, it would conflict with the law and be against public policy.

This Court's construction of the law is hardly in accord with the view of the United States Supreme Court, for, at p. 287 in the *Fishgold* case, *supra*, the Court there said:

"Section 8(c) of the Act recognizes that insurance and other benefits may continue to accrue to an employee on furlough or on leave of absence. An employee on furlough or on leave of absence has a continuing relationship with the employer; he retains a right to be restored to work under specified conditions."

And at p. 289:

"Our construction of the Act finds support in the legislative history. Representative May had charge of the bill on the floor of the House. He explained an amendment to Sec. 8(c) which add-

ed the words 'shall be considered during the period of service in such forces as on furlough or leave of absence' and also elaborated the clause dealing with 'insurance and other benefits.' He said:

"I may say that the chief purpose of the amendment is to preserve the seniority rights of the thousands and hundreds of thousands of railroad employees and other employees of that character who have certain seniority privileges on the railroads. In other words, we put them on furlough during the time they are in the service and *they will even be permitted to count this time on the question of their retirement.* 86 Cong. Rec. 11702'."

"And before that amendment the Committee Report of the Senate stated:

"The Congress, in this bill, has declared as its purpose and intent that every man who leaves his job to participate in this training and service should be re-employed without loss of seniority, or other benefits, upon his return to civil life. S.Rep. No. 2002, 76th Cong. 3rd Sess. p. 8'."

Having seen that Articles VIII and X of the union contract cover entirely *different kinds of leave* and that Article X specifically provides that the employees who "*leave their jobs to serve in the armed forces of the United States * * * shall be granted a leave of absence*" and upon their honorable discharge from active service or duty "*shall then be reinstated to the same or comparable position with severance-pay rating and other rights unimpaired,*" it is inconceivable

that the parties to the contract had in mind the penalizing of the veteran by not permitting him to count the years he shouldered a gun in the defense of his country under the provisions of an entirely different type of leave provided for in paragraph 6 of Article VIII.

Is no significance whatever to be attached to the deliberate elimination from Article X contained in the 1940-1942 contract of the words "*except that such leave (military) may be deducted in computing severance pay*" in the new Article X (Ex. C)?

It would seem clear that the elimination of these words in the subsequent contract containing the new Article X was a forthright promise to these employees that time spent by them in the armed services *would* be considered as "full-time continuous employment by the Seattle Star" as provided in paragraph 4 of Article VIII in computing severance pay. What possible purpose could be served by the elimination of these clear, distinct and understandable words, than the one suggested. It is tantamount to saying, as the Supreme Court of the United States so clearly said with respect to Section 8(c) of the law, in the *Fish-gold* case:

"* * * *his service in the armed services is counted as service in the plant so that he does not lose ground by reason of his absence.*"

A somewhat similar question, involving vacation pay was considered by the Circuit Court of Appeals for the Third Circuit in the case of *Mentzel v. Diamond et al*, 167 F. (2d) 299.

That case had to do with the question of whether in considering vacation pay the time spent by the veteran in the army should be included in computing the years of service with the employer in determining the number of weeks' vacation the veteran would be entitled to under Sec. 4(a) of the union contract with the employer.

Sec. 4(a) of the contract there involved read:

“Employees shall receive vacation of one week with pay after one year's service; vacations of two weeks with pay after five years of service

* * *.”

In reversing the District Court, which refused to count the veteran's army service as being within the phrase “after five years' service * * *” (it appearing from the footnote that the veteran was first employed either in September, 1940, or January, 1941) and it further appearing from the opinion itself that the veteran was inducted into the United States Army on February 17, 1943, and after his honorable discharge was reinstated in his employment on October 22, 1945, and allowed but one week's vacation pay, the Circuit Court of Appeals said (p. 300):

"If Mentzel is entitled to count the period from the beginning of his employment with the company, including the time he spent in the Army, as 'service' he was entitled to two weeks' vacation with pay in 1946.

"If he is not entitled to count the time spent in the army as 'service' with the employer under the terms of this contract, he has received, in his one week's vacation with pay, all that he is entitled to. The latter is the position taken by the learned District Court and upon that basis he gave judgment for the defendant.

"The precise point seems to be new in this Circuit and elsewhere. But we think that the principle on which our own previously decided cases has been rested is sufficient to show what we think should be the answer here. In *Gauweiler v. Elastic Stop Nut Corporation*, 3 Cir., 1947, 162 F. (2d) 448, we examined the decisions of the Supreme Court in *Fishgold v. Sullivan Drydock & Repair Corp.*, 1946, 328 U.S. 275, 66 S.Ct. 1105, 90 L.Ed. 1230, 167 ALR 110, and *Trailmobile Co. v. Whirls*, 1947, 331 U.S. 40, 67 S.Ct. 982.

"We concluded that the analysis of the Supreme Court meant 'that what the Act gives to the veteran is the right not to lose his position or seniority by virtue of his absence in Military or Naval Service.' He is protected, while away, to the same extent as if he had been either continuously on the job in the plant or away on furlough or leave of absence for some personal reason."

Continuing, on p. 301, the Court said:

"Again, in *MacLaughlin v. Union Switch and Signal Company*, 3 Cir. 1948, 166 F. (2d) 46, 48, we read: * * * 'We can see no reason why the

protection of the Selective Training and Service Act of 1940 in appropriate cases should not embrace vacation rights which the employee has earned and would have received as a matter of course but for his induction, * * * the statute was intended to place veterans on the precise point of the vacation escalator which they would have occupied had they kept their positions continuously during the war * * *."

This same principle applies with equal force to severance pay under the contracts in the instant case.

For the foregoing reasons and upon the authorities cited we respectfully pray that the decision rendered in this case be reconsidered or that a rehearing be granted to the end that this Court may give to the statute in this case the liberal construction which the Supreme Court and the Third Circuit have said should be applied in such situations.

Respectfully submitted,

J. CHARLES DENNIS
United States Attorney

JOHN E. BELCHER
Assistant United States Attorney

No.11829

United States
Circuit Court of Appeals
For the Ninth Circuit.

MITCHELL CAMERA CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the Tax Court
of the United States

FILED

MAR - 4 1948

PAUL P. O'BRIEN,

No.11829

United States

Circuit Court of Appeals

For the Ninth Circuit.

MITCHELL CAMERA CORPORATION,

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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APPEARANCES

For Taxpayer:

HARRY FRIEDMAN, ESQ.

For Commissioner:

E. M. WOOLF, ESQ.

The Tax Court of the United States
Docket No. 8058

MITCHELL CAMERA CORPORATION,
Petitioner,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DOCKET ENTRIES

1945

May 15—Petition received and filed. Taxpayer notified. Fee paid.

May 15—Copy of petition served on General Counsel.

May 17—Request for Circuit hearing in Washington, D. C., filed by taxpayer. 5/18/45 granted.

June 20—Answer filed by General Counsel.

June 23—Copy of answer served on taxpayer—Washington, D. C.

Oct. 25—Hearing set 12/10/45.

Nov. 19—Motion for continuance to a future Washington calendar filed by taxpayer. 11/19/45 granted to next Washington calendar.

1946

Apr. 29—Hearing set 6/4/46 at Washington, D. C.

May 31—Motion for a continuance to the next Washington, D. C., calendar filed by taxpayer. 5/31/46 granted.

1946

Aug. 19—Hearing set Oct. 21, 1946, at Washington, D. C.

Oct. 22—Hearing had before Judge Leech on
23 merits. Petitioner granted leave to file amended petition to conform to the proof. Returned subpoena. Stipulation of facts filed at hearing. Petitioner's brief due 12/9/46, respondent's 1/8/47, petitioner's reply 1/23/47.

Oct. 29—Transcript of hearing of 10/22/46 filed.

Oct. 29—Transcript of hearing of 10/23/46 filed.

Nov. 4—Amended petition filed by taxpayer.
11/5/46 copy served.

Nov. 18—Answer to amended petition filed by General Counsel.

Dec. 9—Brief filed by taxpayer. 12/10/46 copy served.

1947

Jan. 8—Motion for extension to Feb. 7, 1947, to file brief filed by General Counsel. 1/9/47 granted and petitioner to 2/24/47.

Feb. 7—Brief filed by General Counsel.

Feb. 24—Reply brief filed by taxpayer. 2/25/47 copy served.

June 24—Memorandum findings of fact and opinion rendered, Leech, J. Decision will be entered under Rule 50. 6/25/47 copy served.

1947

July 24—Motion to vacate and set aside the memorandum findings of fact and opinion filed by taxpayer. 7/25/47 denied.

Aug. 26—Computation for entry of decision filed by General Counsel.

Sept. 4—Consent to Computation filed by taxpayer. [1*]

Sept. 9—Decision entered, Leech, J., Div. 6.

Nov. 3—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Nov. 3—Proof of service filed.

Dec. 12—Certified copy of an order from the 9th Circuit extending the time to January 20, 1948, to prepare and transmit record filed.

Dec. 29—Certified copy of an order from the 9th Circuit directing the Clerk of the Tax Court to transmit all of the original exhibits ten days before this cause is set for argument to the Clerk of 9th Circuit filed.

1948

Jan. 2—Agreed statement of evidence filed.

Jan. 2—Statement of points filed by taxpayer with proof of service thereon.

Jan. 2—Designation of record filed by taxpayer with proof of service thereon. [2]

[Title of Tax Court and Cause.]

AMENDED PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Symbols LA:IT:90D:PB, dated February 27, 1945) and as a basis of its proceeding alleges as follows:

1. The petitioner is a corporation with principal office at 665 North Robertson Boulevard, Los Angeles, California. The return for the period here involved was filed with the Collector for the Sixth District of California.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on February 27, 1945.

3. The taxes in controversy are income and declared value excess profits taxes for the calendar year 1941 in the sums of \$71,301.66 and \$2,177.28, respectively, a total of \$73,478.94, all of which is in dispute.

4. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(1) Determination of the basis of patents and applications for patents and inventions (hereinafter referred to as patents) acquired on July 25, 1929, as \$1,180,157.59 instead of \$2,860,178.95, the cost to petitioner. [3]

(2) Computation of patent depreciation on basis of average life of patents, instead of on the basis of life of patents exhausted within the years involved.

(3) Failure to allow patent depreciation in the sum of \$133,578.91, \$128,538.19 and \$128,528.19 in the years 1939, 1940 and 1941, respectively.

(4) Disallowance of ordinary and necessary expenses designated "special expenses" in the sums of \$1,637.50, \$1,583.71 and \$3,836.60 in the years 1939, 1940 and 1941, respectively.

(5) Disallowance of ordinary and necessary expenses designated as "New York office expenses" in the amount of \$11,161.88 and \$1,574.17 in computing the net operating loss for 1939 and 1940, respectively.

(6) Failure to allow the net operating loss carry-over in the amount of \$124,168.42, from 1939 to 1940.

(7) Failure to allow the net operating loss carry-over in the amount of \$226,817.69 from 1939 and 1940 to the taxable year.

5. The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(1)(a) On July 29, 1929, the petitioner acquired from H. L. Clarke the assets, real property, equipment and patents of the Mitchell Camera Corporation of California for the sum of \$3,100,000.00 in cash. Included in the property so purchased were

tangible assets having a fair market value of \$239,821.05. The principal assets of the said Mitchell Camera Corporation of California were a group of patents having on date of acquisition expiration dates extending beyond the taxable year. The cost of the said patents to the petitioner was \$2,860,178.95.

(1)(b) The respondent in computing the deficiency erroneously considered as the cost of said patents the sum of \$1,180,157.59, determining said amount by deducting from the price of \$1,475,000.00 previously paid by [4] Harley L. Clarke to the stockholders of Mitchell Camera Company of California under a contract dated June 6, 1929, the sum of \$294,841.41, the purported net value of the tangible assets acquired from H. L. Clarke.

(1)(c) The cost of said property to H. L. Clarke was \$1,825,000.00 or more, the difference being the sum of \$350,000.00 to \$400,000.00 paid by H. L. Clarke as commissions to complete his purchase.

(2)(a) The life of the patents acquired was 4452 months. During the years 1939, 1940 and 1941 the life of patents exhausted was 212, 204 and 204 months, respectively.

(2)(b) The respondent in determining the deficiency computed patent depreciation on the basis of the average life of the patents exhausting the said patents prior to the expiration of their life, although the life of the patents had not expired.

(3)(a) The respondent in computing the deficiency allowed patent depreciation on patents acquired in 1929 in the amounts of \$95,430.50 for the year 1939, \$49,187.34 for the year 1940 and none for the year 1941.

(3)(b) The patent depreciation sustained by the petitioner in the years 1939, 1940 and 1941 computed on the basis of the proportion of the exhausted life within the respective years to the total life of the patents, was \$133,578.91, \$128,538.19 and \$128,538.19, respectively.

(4)(a) The petitioner incurred and paid ordinary and necessary expenses in connection with its business designated as "special expenses" in the sums of \$1,637.50, \$1,583.71 and \$3,836.60 in the years 1939, 1940 and 1941, respectively.

(4)(b) The respondent disallowed said "special expenses" in computing the deficiency.

(5)(a) In the taxable years 1939 and 1940 the petitioner incurred and paid ordinary and necessary expenses in connection with its business designated as "New York office expenses" in the amounts of \$11,161.88 and [5] \$1,574.17.

(5)(b) The said sums were expended for rent of space in New York and salaries of employees, and other incidental expenses.

(5)(c) The respondent allowed no portion of said sums in computing the net operating loss for the years 1939 and 1940.

(6) The net operating loss carry-over from 1939 to 1940 was \$124,168.42. The respondent allowed \$56,927.79.

(7) The net operating loss carry-over from 1939 and 1940 to 1941 was \$226,817.69. The respondent allowed \$39,100.79.

Wherefore, the petitioner prays that this Court may hear the proceeding, disallow the deficiency and grant such further and other relief as the nature of the case may warrant.

/s/ HARRY FRIEDMAN,
540 Munsey Building,
Washington, D. C.,
Counsel for Petitioner.

State of New York,
County of New York—ss.

Eva Fox, being duly sworn, says that she is president of the petitioner above-named, that she has read the foregoing petition, and is familiar with the statements contained therein and that the statements contained therein are true.

/s/ EVA FOX.

Subscribed and sworn to before me this 1st day of November, 1946.

/s/ WILLIAM S. ALTMAN,
Notary Public. [6]

EXHIBIT A

[Letterhead Treasury Department]

February 27, 1945

Office of Internal Revenue Agent in Charge, Los
Angeles Division. LA:IT:90D:PB

Mitchell Camera Corporation
665 North Robertson Boulevard
Los Angeles 46, California.

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1941, discloses a deficiency of \$71,301.66, and that the determination of your declared value excess-profits tax liability for the year mentioned discloses a deficiency of \$2,177.28, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Los

Angeles, California, for the attention of LA:Conf. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency or deficiencies and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner.

By GEORGE D. MARTIN,
Internal Revenue Agent
in Charge.

Enclosures:

Statement

Form of Waiver [7]

Statement

Mitchell Camera Corporation
665 North Robertson Boulevard
Los Angeles 46, California

Tax Liability for the Taxable Year
Ended December 31, 1941

	Liability	Assessed	Deficiency
Income tax	\$71,301.66	None	\$71,301.66
Declared value excess profits tax.....	2,177.28	None	2,177.28
Total	<u>\$73,478.94</u>	<u>None</u>	<u>\$73,478.94</u>

In making this determination of your tax liability careful consideration has been given to the report of examination dated October 14, 1943, to your protest dated February 10, 1944, and to the statements made at the conference held.

A copy of this letter and statement has been mailed to your representative, Mr. Sidney R. Reed, 608 South Hill Street, Los Angeles 14, California, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net income (loss) as disclosed by return.....		(\$7,121.24)
Unallowable deductions and additional income:		
(a) Depreciation disallowed....	\$ 93,578.16	
(b) Special expense disallowed	3,836.60	
(c) Bad debt disallowed.....	4,676.78	
(d) Interest income understated	15,479.56	
(e) Net operating less deduction disallowed.....	124,101.71	241,672.81
		<hr/>
Total		234,551.57
Additional deduction:		
(f) Capital stock tax.....		1,562.50
		<hr/>
Net income adjusted.....		\$232,989.07

Explanation of Adjustments

(a) After consideration of the facts with regard to your corporate organization in 1929 and in view of the contract of June 6, 1929, between Harley L. Clarke and H. F. Boeger, acting for himself and George A. Mitchell and others, it is determined that the basis for computation of allowable [8] depreciation on a group of patents and patent applications acquired by you on July 27, 1929, is \$1,180,157.59; further that, inasmuch as no allocation of that basis to each separate patent or application has been established, the above amount is recoverable through depreciation allowances over the average life of the entire group of patents, i.e., over a period of 12.3666 years from July 27, 1929; and it is held that for the calendar year 1941 you are entitled to a deduction of \$1,027.76 as allowable depreciation or amortization of patents and excessive depreciation deducted, amounting to \$93,578.16 is disallowed in accordance with the following computation:

	Patents		Allowed to 12-31-38	Depreciation			Total to 12-31-41
	Acquired	Cost		1939	Allowable 1940	1941	
7/25/29		\$1,180,157.59	\$1,035,539.75	\$95,430.50	\$49,187.34	None	\$1,180,157.59
Add'ns to 12/31/38..		15,627.83	5,618.49	917.14	917.14	\$917.14	8,369.91
1939		450.00		15.52	31.04	31.04	77.60
1940		985.00			26.82	53.64	80.46
1941		1,671.70				25.96	25.96
Totals		\$1,198,892.12	\$1,041,158.24	\$96,363.16	\$50,162.34	\$1,027.78	\$1,188,711.52
Amount disallowed....				5,808.26	52,066.41	93,578.16	
Amount deducted in return				\$102,171.42	\$102,228.75	\$94,605.94	

(b) On your return for the year 1941 you deducted the amount of \$3,836.60 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(c) It is held that the amount of \$4,676.78 deducted by you in the year 1941 as a bad debt of Grossman and Joseph is not an allowable deduction for the reason that it has not been established that a bona fide debt existed or that such alleged debt became worthless in 1941 within the meaning of section 23(k) of the Internal Revenue Code as amended.

(d) It is held that the following amounts of interest receivable on notes and accounts, which were accrued on your books in 1941, constitute taxable income within the meaning of section 22 of the Internal Revenue Code.

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	14,349.56
Kammerman and Witkin.....	450.00

(e) It is determined that the net operating loss deduction claimed by you as a deduction on your return for the year 1941 in the amount of \$163,202.50, is allowable to the extent of \$39,100.79, and the excess amount of \$124,101.71 is accordingly disallowed.

The allowable amount of \$39,100.79 represents the amount of the net operating loss carry-over deter-

mined for the year 1939 reduced by the net income determined for the year 1940, as follows: [9]

Year 1939	
Net loss as reported in your return.....	\$87,952.67
Unallowable deductions and additional income:	
(A) Depreciation disallowed.....	\$ 5,808.26
(B) New York office expense disallowed	11,161.88
(C) Special expense disallowed.....	1,637.50
(D) Interest income understated..	12,417.24
	<hr/>
Net loss adjusted.....	\$56,927.79
Net loss carry-over determined.....	\$56,927.79

Explanation of Adjustments

(A) See adjustment (a) above for explanation of this adjustment.

(B) On your return for the year 1939 you deducted the amount of \$11,161.88 under New York office expenses. It is held that this deduction is not allowable under any section of the Internal Revenue Code.

(C) On your return for the year 1939 you deducted \$1,637.50 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(D) It is held that the following amounts of interest receivable on notes and accounts, accrued on your books in 1939, constitute taxable income within the meaning of section 22 of the Internal Revenue Code:

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	10,513.24
Kammerman and Witkin.....	450.00

It is held also that the amount of \$774.00 received

from John F. Huber on his note dated September 1, 1939, which amount you credited to Eva Fox, constitutes your income.

Year 1940

Net loss as disclosed by return.....		\$163,282.50
Unallowable deductions and additional income:		
(AA) Depreciation disallowed.....	\$52,066.41	
(BB) New York office expense disallowed	1,574.17	
(CC) Special expense disallowed..	1,583.71	
(DD) Interest income understated	12,355.54	
(EE) Bad debt disallowed.....	27,800.00	
(FF) Net operating loss deduction disallowed	87,952.67	183,332.50
Total		\$20,050.00
Additional deduction:		
(GG) Capital stock tax.....		2,223.00
Net income adjusted (before deduction of net loss carry-over from 1939).....		\$17,827.00

Explanation of Adjustments

(AA) See adjustment (a) above for explanation of this adjustment.

(BB) On your return for the year 1940 you deducted the amount of \$1,574.17 under New York office expenses. It is held that this deduction is not allowable under any section of the Internal Revenue Code.

(CC) On your return for the year 1940 you deduction \$1,583.71 under special expenses. It is held that the above amount does not constitute an allowable deduction under any section of the Internal Revenue Code.

(DD) It is held that the following amounts of

interest receivable on notes and accounts, accrued on your books in 1940, constitute taxable income within the meaning of section 22 of the Internal Revenue Code:

Belle Fox.....	680.00
Fox Chicago Realty Corporation.....	10,595.54
Kammerman & Witkin.....	450.00

It is held also that the amount of \$630.00 received from John F. Huber on his note dated September 1, 1938, which amount you credited to Eva Fox constitutes your income.

(EE) It is held that the amount of \$27,800.00 deducted by you in the year 1940 as a bad debt of Mrs. Eva Fox and/or the W. F. Transportation Company is not an allowable deduction for the reason that it has not been established that a bona fide debt existed or that such alleged debt became worthless in 1940 within the meaning of section 23(k) of the Internal Revenue Code.

(FF) The 1939 loss carry-over is eliminated for the purpose of determining 1940 income or loss.

(GG) The deduction allowable for capital stock tax accrued in 1940 is \$2,500.00 in lieu of \$277.00 claimed in your return for that year.

Summary

1939 net loss carry-over.....	\$56,927.79
1940 net income.....	17,827.00

Net operating loss deduction determined.....\$39,100.79

(f) The deduction allowable for capital stock tax accrued in 1941 is \$4,062.50, in lieu of \$2,500.00 claimed in your return for that year. [11]

Computation of Declared Value Excess Profits Tax

Net income.....	\$232,989.07
Less: 10% of \$2,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1941	200,000.00
Net income subject to declared value excess profits tax.....	32,989.07
Declared value excess profits tax: 6.6% of \$32,989.07.....	\$ 2,177.28
Correct declared value excess profits tax liability.....	2,177.28
Declared value excess profits tax as- sessed: Original, account No. NC854087..	None
Deficiency of declared value excess profits tax.....	\$ 2,177.28

Computation of Income Tax

Net income.....	\$232,989.07
Less: Declared value excess profits tax	2,177.28
Normal tax net income.....	\$230,811.79
Surtax net income.....	230,811.79
Income tax:	
Normal tax:	
24% of \$230,811.79.....	55,394.83
Surtax:	
6% of \$25,000.00.....	1,500.00
7% of \$205,811.79.....	14,406.83
Correct income tax liability.....	\$ 71,301.66
Income tax assessed: Original, account No. NC854087	None
Deficiency of income tax.....	\$ 71,301.66

[Title of Tax Court and Cause.]

ANSWER TO AMENDED PETITION

Comes now the Commissioner of Internal Revenue by his Attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amended petition filed herein admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the amended petition.

2. Admits the allegations contained in paragraph 2 of the amended petition.

3. Admits that the taxes in controversy are income and declared-value excess-profits taxes for the year 1941, but denies the remainder of paragraph 3 of the amended petition.

4(1) to (7), inclusive. Denies that the Commissioner erred as alleged in subparagraphs (1) to (7), inclusive, of paragraph 4 of the amended petition.

5(1)(a); (1)(b); (1)(c); (2)(a); and (2)(b). Denies all of the allegations contained in subparagraphs (1)(a), (1)(b), (1)(c), (2)(a), and (2)(b) of paragraph 5 of the amended petition.

5(3)(a). Admits the allegations contained in subparagraph (3)(a) of paragraph 5 of the amended petition. [13]

5(3)(b) and (4)(a). Denies all of the allegations contained in subparagraphs (3)(b) and (4)(a) of paragraph 5 of the amended petition.

5(4)(b). Admits the allegations contained in subparagraph (4)(b) of paragraph 5 of the amended petition.

5(5)(a) and (5)(b). Denies all of the allegations contained in subparagraphs (5)(a) and (5)(b) of paragraph 5 of the amended petition.

5(5)(c). Admits the allegations contained in subparagraph (5)(c) of paragraph 5 of the amended petition.

5(6) and (7). Admits that the respondent allowed a net operating loss deduction for the year 1941 in the amount of \$39,100.79. Denies all other allegations contained in subparagraphs (6) and (7) of paragraph 5 of the amended petition.

Denies generally and specifically each and every allegation contained in the amended petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore, it is prayed that the petitioner's appeal be denied.

/s/ J. P. WENCHEL, PAB

Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

PHILIP A. BAYER,
Division Counsel,

E. M. WOOLF,
Special Attorney,
Bureau of Internal Revenue.

Received and filed Nov. 18, 1946. [14]

[Title of Tax Court and Cause.]

STIPULATION

It is hereby stipulated and agreed by and between the parties hereto through their respective attorneys, that for the purpose of trial and decision, the following statements are true, without prejudice to the right of either party to object to the materiality or relevance of any stipulated facts or to introduce other and further evidence not inconsistent therewith.

1. The petitioner is a Delaware corporation with principal office at 665 North Robertson Boulevard, Los Angeles, California.

2. The notice of deficiency attached to the petition was mailed to petitioner on February 27, 1945.

3. On July 12, 1929, a proposal signed by H. L. Clarke was made to the petitioner, a copy of which is attached and made a part hereof, marked Exhibit 1.

4. Said proposal was accepted by petitioner by resolution adopted by the Board of Directors at a meeting held on July 16, 1929, a copy of the minutes of such meeting is attached hereto and marked Exhibit 2.

5. H. L. Clarke caused to be delivered to petitioner all the properties, business and assets of the Mitchell Camera Company, a California corporation, referred to in the proposal dated July 12, 1929.

6. Copies of certain instruments of transfer attached and made a part hereof, marked respectively:

Exhibit 3. Deed to Lot 7, Tract 5274;

Exhibit 4. Deed to Lots 36 and 38 of Winnetka Tract and Lots 7 and 8 of Tract 3585;

Exhibit 5. Assignment of Entire Interest in Letters Patent;

Exhibit 6. Assignment of an Undivided Two-Thirds Interest in Invention and Patent Application Therefor;

Exhibit 7. Assignment of Entire Interest in Inventions before the Issuance of Letters Patent.

7. The fair market value of the net tangible property so acquired by the petitioner from or through H. L. Clarke was \$239,821.05.

8. The respondent in computing the deficiency determined the basis of patents, applications for patents and inventions acquired by petitioner as aforesaid to be \$1,180,157.59. The respondent allowed depreciation on said patents in the sums of \$95,430.50 for the year 1939, \$49,187.34 for the year 1940 and none for the year 1941, arriving at the said allowance for the year 1939 by spreading the basis over the average life of the patents, namely 12.3666 years.

9. A list of the patents, together with dates of issuance and expiration dates is attached and marked Exhibit 8.

10. The certificate of incorporation of the petitioner was filed on July 12, 1929, in the State of Delaware. Paragraph Tenth and subparagraph (7) thereto read as shown in Exhibit 9, attached.

11. Respondent's allocation of basis of patents was based on the price of \$1,475,000.00 paid by H. L. Clarke to the stockholders of the Mitchell Camera Company, a California corporation, for all the properties, business and assets of the Mitchell Camera Company of California, under a contract dated June 6, 1929, a copy of which is attached, marked Exhibit 10.

12. For the years 1939, 1940 and 1941 the petitioner deducted on its returns as ordinary and necessary expenses the following amounts designated as "special expenses."

1939.....	\$1,637.49
1940.....	1,583.71
1941.....	3,836.61

The respondent in computing the deficiency disallowed the said deductions.

13. For the years 1939 and 1940 the petitioner deducted on its returns as ordinary and necessary

expenses the following amounts designated as "New York office expenses" in the following amounts:

1939.....\$11,161.88

1940..... 1,574.17

The respondent in computing the deficiency disallowed the said deductions.

14. It is further stipulated and agreed that the amount of the net operating loss carry-over from 1939 and 1940 to the taxable year 1941 may be left for settlement under rule 50 of the Rules of Practice after the decision of the court on the other issues.

/s/ HARRY FRIEDMAN,
Attorney for Petitioner.

/s/ J. P. WENCHEL, PAB
Chief Counsel, Bureau of
Internal Revenue.

Filed Oct. 22, 1946. [17]

The Tax Court of the United States

Docket No. 8058

MITCHELL CAMERA CORPORATION,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On the record held:

1. Petitioner has failed to establish error in the basis used by respondent in determining depreciation on its patents.
2. The amounts deductible as ordinary and necessary business expenses determined.

Harry Friedman, Esq., for the petitioner.

E. M. Woolf, Esq., for the respondent. [18]

MEMORANDUM FINDINGS OF FACT AND OPINION

Leech, Judge:

Respondent determined deficiencies in income and declared value excess-profits taxes of petitioner for the year 1941 in the amounts of \$71,301.66 and \$2,177.28, respectively. The determination of the correct net taxable income of petitioner for this year requires the ascertainment of the correct net income of petitioner for the calendar years 1939 and 1940 because of carry-over net losses claimed by it

for those years. The parties agree that upon the determination of that income for 1939 and 1940 the amounts of the carry-over from each year will be determined under Rule 50.

The issues are whether respondent erred (a) in fixing the basis of patents acquired at date of organization of petitioner as \$1,180,157.59 for purposes of computing depreciation, (b) in determining the accumulated reserve for depreciation on such patents to be \$1,035,539.75 as of December 31, 1938, (c) in computing depreciation on such patents during the taxable years 1939, 1940, and 1941, based on a composite average life of 12.3666 years from July 27, 1929, date of acquisition by petitioner, (d) in disallowing New York office expenses in the amounts of \$11,161.88 and \$1,574.17 for the years 1939 and 1940, respectively, and (e) in disallowing "Special Expenses" in the amounts of \$1,637.49, \$1,583.71, and \$3,836.61 for the taxable years 1939, 1940, and 1941, respectively.

Two issues, (1) the disallowance by respondent of alleged worthless debts of \$27,800 and \$4,676.78 in the years 1940 and 1941, respectively, and (2) the inclusion in income for the years 1939, 1940, and 1941 of interest in the respective amounts of \$12,417.24, \$12,355.54, and \$15,479.56, were conceded by petitioner at the hearing. These adjustments will be reflected in the recomputation under Rule 50.

Certain of the pertinent facts were stipulated by the parties and are so found. Such facts in our findings of fact as are not included among those stipulated we find upon the testimony and exhibits.

Findings of Fact

The petitioner is a Delaware corporation organized on July 12, 1929, with principal office at Los Angeles, California. The return for the year here involved was filed with the collector for the sixth district of California.

Mitchell Camera Company of California (hereinafter referred to as "Mitchell of California") for a number of years prior to 1929 was engaged in the business of manufacturing professional motion-picture cameras and accessories for the large motion-picture studios in California. All of its business was in patented products manufactured under patents owned by it. In 1927 the introduction of "sound" motion pictures revolutionized the motion-picture industry and Mitchell of California became the sole supplier of cameras for the major motion-picture studios. This was due to the fact that under its patents were produced cameras relatively noiseless in comparison with those of its competitors. Because of the patented features of the Mitchell camera, it was practically impossible to use any other camera in the production of "sound" motion pictures, and the demand for Mitchell cameras increased greatly, resulting in a large backlog of incompleated orders in 1929. In that year the stock of Mitchell of California was owned two-thirds by Henry F. Boeger, who was its president, and one-third by George A. Mitchell, who was its secretary. [20]

Prior to May 1929, Harley L. Clarke, not then financially interested in Mitchell of California, be-

came interested in acquiring its business and assets. In 1929 William Fox was president of the Fox Film Corporation and of Fox Theatres Corporation, and was otherwise generally engaged in the motion picture business. Fox had been president of both corporations since their organization, the film corporation having been organized in 1915 and the theatres corporation in 1925. William Fox is now general manager of petitioner. His family now controls the stock of petitioner through ownership of stock in All Continent Corporation, a holding company.

The petitioner's capital upon organization consisted of 30,000 shares of common stock, no-par value. Grandeur, Incorporated (hereinafter referred to as "Grandeur"), purchased the entire capital stock of petitioner "as of July 1, 1929" for the stated sum of \$3,100,000, under circumstances hereinafter described.

The salient facts leading to the organization of the petitioner and its acquisition of the patents involved are set out chronologically as follows:

On May 24, 1929, Harley L. Clarke addressed a letter to William Fox, which letter is signed "Accepted, William Fox." This letter confirms an agreement between Clarke and Fox. Clarke agrees to cause to be organized a corporation to be known as Grandeur, Incorporated, the chief object of which shall be the purchase, sale, lease, and/or license of motion-picture projectors, cameras, and/or equipment or devices to be used in connection with motion-picture projectors. Clarke agreed "to cause

a subscription to be made for one-half of such capital stock" and Fox agreed to subscribe for the other one-half at a cost to each of \$250,000 in cash. On this same [21] day, a second letter was addressed to William Fox by H. L. Clarke, and was signed by Fox as approving and acknowledging his understanding. It reads as follows:

With reference to agreement entered into between us, today, concerning the wide film situation, this will confirm our understanding that after Grandeur, Inc., has been duly organized and its business affairs in operation, out of the first profits earned and before any dividends shall have been paid, you shall be reimburse in the sum of One Million (\$1,000,000) Dollars, and I shall be reimbursed in the sum of Five Hundred Thousand (\$500,000) Dollars for expenditures, labor, overhead, and services for research work in the development of the wide film art.

Grandeur, Inc., shall cause to be created and delivered to each of us a note or other form of acknowledgment or indebtedness suitable to our respective counsel, evidencing the foregoing arrangements.

On the next day, May 25, 1929, H. L. Clarke addressed a letter to William Fox, which is signed by Fox "Approved and agreed as to our understanding." This letter reads in part:

I am now negotiating for the purchase of the Mitchell Camera Co. This purchase shall

be for the benefit of a corporation to be organized by us, one half of the stock of which is to be owned by each of us. This corporation shall be either independently operated by us or shall be a wholly owned subsidiary of Grandeur, Inc., as shall be mutually agreed upon between our respective counsel.

On June 6, 1929, a contract was executed by and between H. F. Boeger and George A. Mitchell, called the "sellers," and H. L. Clarke, called the "buyer." The terms of this agreement provide in part as follows:

* * * * *

1. The sellers agreed to sell or caused to be sold and the buyer agrees to purchase or cause to be purchased, as hereinafter provided, all of the property, business and assets of every kind and nature of the Mitchell Camera Co., a California corporation, hereinafter sometimes referred to as the corporation, including in such property, business and assets, furniture, fixtures, jigs, dies, tools, patterns, machinery, merchandise on hand, claims, insurance, securities, choses in action, [22] contracts agreements, leases, leasehold interests, licenses, trade marks, trade names, trade rights, brands, patents, application for patents, patent rights, also all cash and accounts receivable received by or becoming due to the corporation after June 30, 1929, and the good will of the business of the corporation or a similar name by or in connection with a corporation to be organized by the buyer to carry on a business

similar to that carried on by the corporation. The sellers also agree to cause to be conveyed to the buyer free and clear of all liens, claims and encumbrances the real estate and improvements being constructed thereon, situated in West Hollywood, county of Los Angeles, State of California, more particularly hereinafter described, being the proposed new manufacturing plant, offices and administration building of the corporation, said improvements to be fully completed in accordance with the existing plans and specifications relating thereto, with equipment and machinery to be installed therein.

* * * * *

2. The sellers hereby represent and warrant that the corporation now owns or will acquire all letters patent under which it manufactures its products, said patents to be included in the assets to be sold to the buyer.

3. The purchase price of said property, business, and assets shall be the sum of \$1,475,000, payable as herein provided.

4. The buyer shall forthwith deposit with Continental Illinois Bank & Trust Co., Chicago, Ill., the sum of \$100,000, which said sum shall be held in escrow by said bank and applied on the purchase price as herein provided.

(a) The buyer shall forthwith proceed to cause to be organized a corporation to acquire the assets, business, and property of the corporation (hereinabove described) for conven-

ience hereinafter called the "New Corporation." The details of the organization of the corporation and the charter provisions shall be subject to the approval of counsel of the sellers and the buyer, said organization to be completed on or before July 1, 1929. The corporation shall have an authorized issue of preferred [23] stock in the amount of \$1,000,000, consisting of 10,000 shares of the par value of \$100 per share, said preferred stock to be cumulative as to dividends in the amount of 7 per cent per annum. Said preferred stock shall be fully paid and non-assessable. The charter of the new corporation shall contain certain restrictions on corporate action as set forth in Schedule A, annexed hereto and made a part hereof.

(b) On or before September 1, 1929, the buyer shall cause to be deposited with said Continental Illinois Bank & Trust Co. an additional sum of \$375,000, and 10,000 shares of the preferred stock of the new corporation, together with an agreement by the new corporation and H. L. Clarke jointly and severally to purchase from the seller said 10,000 shares of preferred stock of said new corporation at the par value thereof, \$100 per share, plus accrued dividends thereon at the rate of 7 per cent per annum, to be taken up and paid for as follows:

* * * * *

6. It is further agreed that the sellers shall, contemporaneously with the consummation of the pur-

chase hereunder, cause to be executed a contract or contracts with the new corporation by which the sellers shall obligate themselves for a period of 5 years after the consummation of such purchase not to engage or to become interested, directly or indirectly, as an individual, partner, or stockholder, director or officer or employee in or to any motion-picture camera business, other than with the buyer or the new corporation.

7. The sellers and each of them further agree that at the request of the buyer they shall become employed by the new corporation in the same capacities as they now serve with the corporation for a period of at least 1 year and at a salary for each of them of \$25,000 per annum, payable monthly, beginning July 1, 1929.

* * * * *

On June 13, 1929, Grandeur was incorporated under the laws of New York State. Capital was represented by 100,000 shares common stock, no-par value. One-half of its stock was acquired by William Fox and one-half by H. L. Clarke interests, for a stated consideration of \$4,000,000, under circumstances hereinafter described. [24]

On June 24, 1929, a contract was executed between Grandeur, as licensor (referred to therein as Grandeur), and Fox Theatres Corporation, as licensee (referred to therein as Fox). The relevant terms are as follows:

1. (a) Grandeur hereby grants to Fox a non-exclusive, non-assignable license to use in the

theatres owned, controlled and/or operated by Fox, Fox Films Corporation and their respective subsidiary and/or affiliated companies (subject to all the terms, conditions, limitations and agreements herein contained) special motion picture projectors, without lamp or lamphouse, adapted for use in connection with so-called "Grandeur" films (films wider than the regular 35 M.M.) in the quantities and at the times hereafter in this agreement provided and to employ and make use of (to the extent necessarily involved in such use of said projectors) any and all United States patents and applications for United States patents, relating to said projectors or to such use thereof, which are now owned or controlled, or which may during the term of this agreement be owned or controlled by International Projector Corporation, or in respect of which International Projector Corporation has or may hereafter during the term of this agreement have the right to grant such licenses, Grandeur being the licensee of International Projector Corporation, with the right to assign such use of such patents.

(b) Grandeur agrees to install in such theatres of Fox Film Corporation and/or their subsidiary or affiliated Companies that Fox may from time to time designate, twelve (12) such special motion picture projectors, for which Fox shall pay Grandeur on installation thereof the sum of Six Thousand Dollars (\$6,000).

Grandeur agrees to supply to Fox, and Fox agrees to accept or cause to be accepted from Grandeur

under the terms provided in this Agreement, during the period commencing approximately February 1, 1930, but in any event as soon as projectors shall be ready for delivery, and ending ten (10) years thereafter, all motion picture projectors using films wider than the regular 35 M.M. that may be required or desired by Fox, Fox Films Corporation and/or their subsidiary or affiliated Companies during such period, it being the agreement of the parties hereto that Fox shall, during such period, use exclusively such projectors as are manufactured by International Projector Corporation. Where hereinafter referred to, Fox shall include not only Fox Theatres but also Fox Film Corporation and/or their subsidiary or affiliated Companies. [25]

* * * * *

4. For each such projector in excess of the twelve (12) projectors mentioned in Paragraph 1 (b) hereof, Fox agrees to pay to Grandeur in New York Exchange an installation charge of Four Thousand Dollars (\$4,000) for each such projector, payable upon the shipment of each such projector and the further payments hereinafter provided. In the event that the established installation charge made by Grandeur for such projectors is less than Four Thousand Dollars (\$4,000) at any time during the life of this contract, Fox shall be given the benefit of any such decreased charge from the effective date thereof.

5. In addition to any other payments required to be made by Fox hereunder, Fox agrees to pay

to Grandeur throughout the term of the license hereby granted, a monthly payment of \$175.00/100 in advance. Such payments shall continue for one hundred and twenty (120) months for each projector. Such monthly payment to be made by Fox to Grandeur, however, shall never be in excess of the amount in effect as the established monthly payment at the time when such monthly payment is due. The first six machines furnished, however, shall be free from such monthly payment.

* * * * *

8. Title to and ownership of any and all projectors at any time furnished hereunder shall remain vested in Grandeur.

* * * * *

11. * * * In the event of a default in any of the provisions of this agreement at any time during the first two (2) years of the terms of this license, the entire balance of monthly payments for the first five (5) years shall be due and payable forthwith at the option of Grandeur * * *.

* * * * *

16. These licenses to be granted hereunder in respect to each projector shall be for a term of ten (10) years from the day upon which the installation of each respective projector shall have been completed and the projector made available to Fox for use, the last term to expire five (5) years from the date of installation in 1939 of the last projector provided for in Paragraph 1 of this agreement.

On July 11, 1929, General Theatres Equipment, Inc. (hereinafter referred to as "G.T.E."), was organized for the purpose of taking over the properties of the International Projector Corporation and other properties [26] intended to be acquired. In 1929 Clarke owned "just over control" stock of G.T.E., and was an officer and controlling stockholder of International Projector Corporation that was taken over by G.T.E.

On July 12, 1929, petitioner was incorporated in the State of Delaware. Its charter contains, inter alia, the following provisions:

Tenth. The following provisions are inserted for the regulation of the business and for the conduct of the affairs of this Corporation, and in further definition, limitation and regulation of the powers of this Corporation and of its directors and stockholders: * * *

(7) A director of this Corporation shall not in the absence of fraud be disqualified by his office from dealing or contracting with this Corporation either as a vendor, purchaser or otherwise, nor in the absence of fraud shall any transaction or contract of this Corporation be void or voidable or affected by reason of the fact that any director, or any firm of which any director is a member, or any corporation of which any director is an officer, director, or stockholder, is in any way interested in such transaction or contract, provided that at the meeting of the Board of Directors or of a

committee thereof having authority in the premises, authorizing or confirming said contract or transaction, the interest of such director, firm or corporation is disclosed or made known and there shall be present quorum of the Board of Directors or of the directors constituting such committee, and such contract or transaction shall be approved by a majority of such quorum, which majority shall consist of directors not so interested or connected. Nor shall any director be liable to account to this Corporation for any profit realized by him from or through any such transaction or contract of this Corporation ratified or approved as aforesaid, by reason of the fact that he or any firm of which he is a member, or any corporation of which he is a stockholder, director or officer was interested in such transaction or contract. Directors so interested may be counted when present at meetings of the Board of Directors or of such committee for the purpose of determining the existence of a quorum. Any contract, transaction or act of this Corporation or of the Board of Directors or of any committee thereof which shall be ratified by a majority in interest of a quorum of the stockholders having voting power at any annual meeting or any special meeting called for such purpose, shall be as valid and as binding as though ratified by every stockholder of this Corporation. * * * [27]

On the same date, a proposal signed by H. L. Clarke was made to petitioner to transfer to it all the properties, business, and assets of Mitchell of California for a stated consideration of \$3,100,000 in cash. This proposal refers to a balance sheet annexed thereto, marked Exhibit "A" and made a part thereof. This balance sheet shows a net worth (capital stock and surplus) of \$330,480.50 for Mitchell of California, as of December 31, 1928. Clarke's proposal contains a sentence reading:

* * * The undersigned represents to you that at the date of the acquisition by you of said properties, business and assets of said Mitchell Camera Company your financial condition will be at least as good as is reflected on the pro forma balance sheet annexed hereto, marked Exhibit "A," and made a part hereof.

At a special meeting of the board of directors of petitioner held July 16, 1929, the president (H. L. Clarke) occupied the chair. Henry F. Boeger, one of the sellers of Mitchell of California, was elected a vice-president. The chairman (H. L. Clarke) stated it was advisable to open a bank account in the Chase National Bank of the City of New York. Thereupon, a resolution was adopted, authorizing its officers and agents to deposit funds of petitioner in Chase National Bank of the City of New York, and to withdraw the same upon checks or instruments, drawn against the account "and made or signed by H. L. Clarke, President, or signed by S. R. Burns, Vice President, and countersigned by

W. C. Michel, Treasurer.” The directors further resolved that Chase National Bank be authorized to accept, honor, cash, and pay without limit as to amount, and until written notice of revocation of the authority is actually received by said bank, all checks and other instruments for the payment of money, including all such instruments [28] “payable or endorsed to the personal order of the officer or officers or agent or agents signing on behalf of this Corporation.” At this same meeting, a resolution was adopted accepting Clarke’s July 12, 1929 proposal to sell the assets of Mitchell of California to petitioner for \$3,100,000 and authorizing its proper officers to execute all necessary documents to carry this resolution into effect.

Clarke presented to this meeting a proposal by Grandeur (of which Clarke was president) to acquire all of the capital stock of petitioner. This proposal is in the following form:

The undersigned hereby offers to purchase Thirty Thousand (30,000) shares of your capital stock without par value, being all of your authorized capital stock, for the sum of Three Million One Hundred Thousand (\$3,100,000) Dollars in cash, subject to and upon condition that your Corporation acquires all of the assets of Mitchell Camera Company, a California corporation, so that as a result of such acquisition by your Corporation and the receipt by your Corporation of such \$3,100,000 in cash

the financial condition of your Corporation will be at least as good as the financial condition of Mitchell Camera Company as shown by the latter Company's balance sheet dated December 31, 1928, a copy of which is attached hereto, marked Exhibit "A."

The Exhibit "A" balance sheet referred to is identical with the balance sheet hereinabove referred to, and shows net worth of \$330,480.50.

By appropriate resolution, the foregoing proposal of Grandeur was duly accepted by petitioner's board of directors.

The signature of H. L. Clarke is appended at the close of these minutes.

On July 27, 1929, a deed was signed by Mitchell of California, by H. F. Boeger, president, and George A. Mitchell, secretary, transferring real property in Los Angeles County, Lot 7 of Tract 5274, from that corporation direct to petitioner. Also on July 27, 1929, a deed was signed by Henry F. Boeger, [29] George A. Mitchell, and their respective wives, transferring real property in Los Angeles County, Lots 36 and 38 of the Winnetka Tract, and Lots 7 and 8 of Tract No. 3585, from those individuals direct to petitioner. Both these deeds were recorded September 3, 1929. All of this real estate constituted part of the property included in the contract of June 6, 1929, to be sold to H. L. Clarke by Boeger and Mitchell for the consideration of \$1,475,000.

On July 27, 1929, assignments of patents and applications for patents were made to petitioner as follows:

(a) Mitchell of California, as sole owner, assigned and transferred its whole right, title and interest in and to 25 patents.

(b) H. F. Boeger and George A. Mitchell transferred their two-thirds interest in an application for patent for an improvement in making composite pictures, applied for January 17, 1927, Serial No. 161,639.

(c) George A. Mitchell sold, assigned and transferred all his right, title and interest in applications for six patents enumerated therein.

In all, 30 patents and patent rights on which patents were ultimately obtained, being all the patents and patent rights belonging to Mitchell of California, were transferred to petitioner.

Under date of July 29, 1929, a letter was addressed to Continental Illinois Bank and Trust Co., Chicago, Illinois, signed by H. F. Boeger, [30] and by H. F. Boeger, as attorney in fact for George A. Mitchell. According to its terms, H. L. Clarke has theretofore deposited with the bank the contract dated June 6, 1929, under which Boeger and Mitchell were conveying to Clarke or his nominee the real property described in the contract, together with all the assets of Mitchell of California. This letter transmitted the deeds to the real property and the assignments of patents and patent applications

above referred to, together with a bill of sale covering the personal property described in the contract of June 6, 1929. The letter, in part, states:

The buyer, H. L. Clarke, has heretofore deposited with you for the undersigned the sum of \$100,000.00 and will on or about August 7, 1929, or before, deposit an additional \$1,375,000.00 for the undersigned. The above mentioned agreement, dated June 6, 1929, provides for a repurchase agreement to be executed by the buyer for the repurchase of the preferred stock therein mentioned. Since the transaction does not involve any stock this provision for the repurchase agreement will not concern you.

You are hereby instructed to collect for the undersigned from the buyer interest on the above-mentioned sum of money, to-wit: \$1,475,000.00 at the rate of seven per cent, per annum, from July 1, 1929, until paid and to hold all of said moneys until further instructions. * * *

Under the terms of the June 6, 1929 contract, the purchasing group was to pay \$475,000 in cash and \$1,000,000 in preferred stock of a new corporation. Clarke notified Boeger and Mitchell he had decided to pay all cash. The agreement was consummated in cash. The \$1,475,000 was not paid to Boeger and Mitchell until the Fall of 1929.

On August 1 and 2, 1929, a series of concurrent financial transactions occurred in effectuating the acquisition by Grandeur of all the capital stock in petitioner and in consummating the acquisition by

petitioner through Clarke of all the business and assets of Mitchell of California. These transactions [31] are summarized, chronologically set forth, and separately numbered:

1. On August 1, 1929, G.T.E. received \$11,400,000 from the sale of its securities. Of this fund, \$2,000,000 was used to acquire 50,000 shares, or 50 per cent of capital stock of Grandeur, and \$3,000,000 was used to acquire J. E. McCauley Manufacturing Company, Strong Electric Company, Ashcraft Automatic Arc Company and Hall and Connolly, Inc. (hereinafter referred to as "the four lamp companies.") Clarke handled these transactions and had general direction of acquiring this one-half stock interest in Grandeur, and also of acquiring the four lamp companies on behalf of G.T.E.

2. On August 1, 1929, Clarke deposited \$5,000,000 to his credit at Chase National Bank, New York, New York, resulting in a balance in his account on that date of \$5,025,024.29.

3. On August 1, 1929, H. L. Clarke issued two checks payable to William Fox for the acquisition by Fox of the other one-half interest in Grandeur. These checks drawn on Chase National Bank, signed by H. L. Clarke, are in the respective amounts of \$1,625,000 and \$375,000, aggregating \$2,000,000, and are endorsed by Fox "For Deposit." Clarke's account at Chase National Bank discloses a withdrawal of \$2,000,000 on August 2, 1929, bearing a notation "cc" (certified check).

4. William Fox acknowledged receiving the two checks aggregating \$2,000,000 from Clarke, but Fox

testified that he gave the "Harley Clarke interests" \$2,000,000 of checks in exchange. For the two checks from Clarke, Fox by check dated August 1, 1929, paid into Grandeur \$1,950,000 toward his one-half interest in its capital stock. Prior to that date he had put up or given Clarke \$50,000 as a down payment to apply on the [32] purchase of the assets of Mitchell of California. Fox's check for \$1,950,000 is dated August 1, 1929, payable to the order of Grandeur, drawn on National City Bank of New York, and signed for William Fox by his duly authorized agents. The check certified August 2, 1929, by the National City Bank, is endorsed "For Deposit and Credit to Account of Grandeur, Inc." On the same day the Chase National Bank received payment for the account of Grandeur.

5. Clarke's account at Chase National Bank similarly discloses a withdrawal of \$1,950,000 on August 2, 1929, in addition to the withdrawal of \$2,000,000 on the same date for the checks to Fox referred to in step 3 above.

6. Under date of August 1, 1929, Grandeur issued its check, drawn on Chase National Bank, in the amount of \$3,000,000, payable to the order of "Mitchell Camera Corporation," and signed "Grandeur, Inc., by H. L. Clarke, President." This check is endorsed "For Deposit & credit to Account of Mitchell Camera Corporation," and was honored by the Chase National Bank August 2, 1929.

7. The bank account of petitioner at Chase

National Bank shows a deposit of Grandeur's check in the amount of \$3,000,000 on August 2, 1929. On the same date it shows a withdrawal of \$3,000,000, representing a check issued to Clarke, leaving no balance.

8. On August 2, 1929, H. L. Clarke's account at Chase National Bank shows a deposit of petitioner's check for \$3,000,000. This deposit is credited on the bank statement immediately prior to Clarke's withdrawals on the same date of \$2,000,000 and \$1,950,000, referred to in steps 3 and 5 above. [33]

After the consummation of these check transactions on August 1 and 2, 1929, G.T.E. owned one-half of the capital stock of Grandeur, at a cost of \$2,000,000, and William Fox owned the other half at no cost to him. Grandeur, in turn, owned and continued to own all the capital stock of petitioner through the taxable year 1941.

The consolidated statements of assets and liabilities as at July 1, 1929, and December 31, 1929, attached to the 1929 consolidated income tax return filed by Grandeur and petitioner, disclose that Grandeur had \$4,000,000 capital stock outstanding, represented by 100,000 shares common stock—no-par value, and that Grandeur owned the entire capital stock of petitioner, carried at a book value of \$3,100,000. The July 1, 1929 statement of assets and liabilities discloses that Grandeur retained \$900,000 undisbursed cash to be used as working capital.

The amount of \$1,475,000 paid to acquire the business and assets of Mitchell of California was

obtained by Clarke from G.T.E. out of its \$11,400,000 fund. Clarke had deposited \$100,000 on or before July 1, 1929, under the agreement of June 6, 1929, of which Fox had advanced \$50,000. Fox was later reimbursed for his \$50,000 advance by the check for \$2,000,000 dated August 1, 1929, received in exchange for his \$1,950,000 check. Clarke paid the balance due under the June 6, 1929 contract, \$1,375,000 plus interest, \$14,627.58, total \$1,389,627.58, on August 24, 1929.

Out of G.T.E.'s \$11,400,000 fund, \$3,000,000 was paid to Clarke to acquire the four lamp companies. To acquire these companies, Clarke paid an aggregate of \$1,757,422.93, the individual amounts paid being as follows: [34]

J. E. McCauley Manufacturing Co.....	\$1,131,422.93
Strong Electric Company.....	316,000.00
Ashcraft Automatic Arc. Co.....	150,000.00
Hall and Connolly, Inc.....	160,000.00
<hr/>	
Total	\$1,757,422.93

In addition to the two checks aggregating \$2,000,000 which Clarke gave Fox, Clarke also gave Fox 25,000 shares of G.T.E. stock, at \$30 per share, with a repurchase agreement, valued at \$750,000. G.T.E. had approximately 2,000,000 shares of stock outstanding.

Grandeur and petitioner filed a consolidated income tax return for the period July 1 to December 31, 1929, reporting a consolidated net income of \$233,796.07 and a tax liability of \$25,717.57. This return is sworn to by H. L. Clarke, president. A

notation attached thereto reads: "Grandeur, Inc., purchased the entire capital stock of Mitchell Camera Corporation as of July 1, 1929." The statement of assets and liabilities for petitioner "as of July 1, 1929," includes net tangible assets \$239,821.05, good will \$2,805,157.59, patents \$55,021.36, and capital stock outstanding \$3,100,000, and is as follows:

Assets		Liabilities	
Land	\$ 35,535.40	Capital stock	
Buildings	73,938.48	represented by	
Machinery and		30,000 shares	
Equipment	91,008.70	common — no	
Land held for		par value.....	\$3,100,000.00
sale	2,050.32	Reserve for de-	
Patents	55,021.36	preciation	12,760.82
Good Will.....	2,805,157.59	Accounts pay-	
Accounts		able	2,815.00
receivable	2,815.00	Accrued payroll..	847.80
Inventory	50,896.77		
Totals	\$3,116,423.62		\$3,116,423.62

The December 31, 1929 statement of assets and liabilities of petitioner attached to the 1929 return discloses the values of good will and patents reported at \$2,805,157.59 and \$52,961.28, respectively. A deduction for depreciation on all assets of \$7,765.94 was claimed by petitioner in the return for the period July 1 to December 31, 1929. No adjustment of the depreciation claimed in the return was made by the respondent.

The 1930 consolidated income tax return of Grandeur and petitioner reported a net income of \$84,213.47. Patents were reported at a net value

of \$52,961.28 at the beginning of the year; and at a value of \$92,768.11 less a reserve for depreciation of \$42,028.91, or a net value of \$50,739.20 at the end of the year. A value of \$2,805,157.59 was reported for "Good Will, Franchise Rights, and Going Concern Value" at both the beginning and end of the year. The deduction for depreciation of patents claimed on the return was \$5,347.98 (approximately 1/17th of average basis of \$92,518.61).

The 1931 consolidated income tax return of Grandeur and petitioner reported patents at a value of \$92,768.11 less a reserve for accumulated depreciation of \$42,028.91, or a net value of \$50,739.20 at the beginning of the year, and at a value of \$94,833.11 less a reserve for depreciation of \$47,514.16, or a net value of \$47,318.95 at the end of the year. A value of \$2,805,157.59 was reported for "Good Will, Franchise Rights, and Going Concern Value" at both the beginning and end of the taxable year. The deduction for depreciation of patents claimed on the return was \$5,485.25 (approximately 1/17th of \$94,833.11).

The Revenue Agent in reports dated March 3, 1932, and April 10, 1933, proposed deficiencies based on revisions of consolidated net incomes reported for [37] 1930 and 1931, respectively, on issues other than depreciation of patents. These deficiencies and net incomes were subsequently redetermined by allowances to petitioner of additional depreciation of \$90,082.52 for 1930, and \$89,945.25 for 1931, on the patents acquired at organization, the revised basis, life, amortization allowable, and additional patent

depreciation allowances being computed in Revenue Agent's letter to Grandeur, dated January 5, 1934, as follows:

Total paid into Grandeur, Inc., by Harley Clark and William Fox..		\$ 4,000,000.00
Paid by Grandeur for net assets of Mitchell Camera Co. of California		3,100,000.00
		<hr/>
Balance — Cash remaining in Grandeur		\$ 900,000.00
Cost of assets—Mitchell Camera Co. of California as above.....		\$ 3,100,000.00
Net assets claimed other than good will		294,842.41
		<hr/>
Good will and intangibles.....		\$ 2,805,157.59
Actual value paid by Harley Clark [sic] for total assets per letter to "Continental Illinois Bank and Trust Co.," Chicago, Ill. Photostatic copy with 1930 revised schedules		\$ 1,475,000.00
Less Net assets other than good will		294,842.41
		<hr/>
Considered as value of patents Life 12.36666 years—amortization allowable		\$ 1,180,157.59
		\$ 95,430.50
	Year 1930	Year 1931
Amortization allowable (above).....	\$ 95,430.50	\$ 95,430.50
Amortization allowable per return	5,347.98	5,485.25
	<hr/>	<hr/>
Additional	\$ 90,082.52	\$ 89,945.25

Grandeur and petitioner agreed to revised deficiencies computed on the basis of the foregoing additional depreciation of patent allowances, evidenced by the filing of a waiver of restrictions on

assessment and collection of deficiencies in taxes amounting to \$4,075.84 for 1930, and \$471.17 for 1931. This agreement, executed on Treasury Department Form 870, dated December 22, 1933, is signed for Grandeur and Affiliated Companies by "William Fox, Pres." and was accepted by Bureau letter dated April 19, 1934.

Prior to the closing of the returns for the taxable years 1930 and 1931, Grandeur and petitioner had filed a consolidated return for 1932 reporting a net loss of \$102,819.84. In statements of assets and liabilities attached to this return, the value of good will of petitioner was reported at \$1,555,157.59 as at the beginning and end of the year, and the value of patents was reported at \$1,344,833.11 as the beginning, and at \$1,345,909.91 as at the end of the year. These figures reflected a write-down of \$1,250,000 in the good will account and an identical write-up of that amount in the patent account, compared with 1931 closing balances as follows:

	Good Will	Patents
Opening 1932 balances.....	\$1,555,157.59	\$1,344,833.11
Closing 1931 balances.....	2,805,157.59	94,833.11
	<hr/>	<hr/>
(Decrease) or increase.....	(\$1,250,000.00)	\$1,250,000.00

Petitioner reported details for patents in the depreciation schedule on its 1932 return as follows:

Depreciable patent value.....	\$1,345,909.91
Depreciation on patents allowed (or allowable) in previous years.....	\$ 291,787.71
Depreciation deducted taxable years.....	\$ 106,676.73

The depreciation deducted by the petitioner on its 1932 return was not changed by the respondent.

In statements of assets and liabilities attached to its 1933, 1934, 1935, 1936, 1937, and 1938 income tax returns, petitioner reported the following values of good will and patents as at the beginning and end of each taxable year:

	Goodwill	Patents
January 1, 1933.....	\$1,555,157.59	\$1,345,909.91
December 31, 1933.....	1,555,157.59	1,350,363.26
December 31, 1934.....	1,555,157.59	1,353,084.58
December 31, 1935.....	1,555,157.59	1,353,816.58
December 31, 1936.....	1,555,157.59	1,354,146.58
December 31, 1937.....	1,555,157.59	1,354,636.94
December 31, 1938.....	1,555,157.59	1,354,710.04

For the taxable years 1933 through 1938, inclusive, the following depreciable patent values, depreciation on patents allowed (or allowable) in previous years, deductions for depreciation of patents, and net losses were reported on income tax returns filed by petitioner:

	Depreciable Patent Values	Depreciation allowed (or allowable) Previous Years	Depreciation Taxable Year	Net Losses Reported
1933	\$1,350,363.26	\$398,463.44	\$106,885.24	(\$93,726.56)
1934	1,350,363.26	505,348.68	107,068.24	(78,281.83)
1935	1,350,363.26	612,416.92	107,139.43	(65,964.83)
1936	1,354,146.58	719,556.35	107,175.31	(3,619.65)
1937	1,354,636.94	826,731.66	107,203.46	(32,630.05)
1938	1,354,710.04	933,935.12	107,223.12	(17,495.03)
Total			\$642,694.80	

The depreciation deductions claimed by the petitioner for 1933 to 1938, inclusive, were not changed by the respondent.

In statements of assets and liabilities attached to its 1939, 1940 and 1941 income tax returns petitioner

reported the following values of good will and patents at the beginning and end of each taxable year:

	Goodwill	Patents
January 1, 1939.....	\$1,555,157.59	\$1,354,710.04
December 31, 1939.....	1,555,157.59	1,355,160.04
<hr/>		
January 1, 1940.....	\$1,555,157.59	\$1,355,160.04
December 31, 1940.....	1,555,157.59	1,356,145.04
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January 1, 1941.....	None	\$ 105,895.54
December 31, 1941.....	\$1,680,021.36	1,198,892.12

For the taxable years 1939, 1940, and 1941, the following depreciable patent values, depreciation on patents allowed (or allowable) in previous years, deductions for depreciation of patents, and net losses were reported in returns filed by petitioner:

	Depreciable Patent Values	Depreciation allowed (or allowable) Previous Years	Depreciation Taxable Year	Net Losses Reported
1939	\$1,355,160.04	\$1,041,158.24	\$102,171.42	(\$87,952.61)
1940	1,355,160.04	1,143,329.66	102,228.75	(163,282.50)
1941	1,198,892.12	1,097,000.46	94,605.94	(7,121.24)

In the notice of deficiency the respondent determined that the basis for computation of allowable depreciation of the group of patents and patent applications acquired on July 27, 1929, was \$1,180,157.59; that the said amount is recoverable through depreciation allowances over the average life of the entire group of patents, namely 12.3666 years from July 27, 1929, and that for the taxable years 1939, 1940, and 1941 petitioner is entitled to deductions of [40] \$96,363.16, \$50,162.34, and \$1,027.78, respectively, as allowable depreciation of patents, computed as follows:

Patents		Depreciation			
Acquired	Cost	Allowed to 12-31-38	Allowable		Total to 12-31-41
			1939	1940	
7/25/29	\$1,180,157.59	\$1,035,539.75	\$95,430.50	None	\$1,180,157.59
Add'ns to 12/31/38..	15,627.83	5,618.49	917.14	917.14	8,369.91
1939	450.00		15.52	31.04	77.60
1940	985.00			26.82	80.46
1941	1,671.70			25.96	25.96
Totals	\$1,198,892.12	\$1,041,158.24	\$96,363.16	\$50,162.34	\$1,188,711.52
Amount disallowed....			5,808.26	52,066.41	93,578.16
Amount deducted in return			\$102,171.42	\$102,228.75	\$94,605.94

H. F. Boeger was elected vice-president of petitioner at a meeting of the board of directors held August 2, 1929. For the year 1930 Boeger received a salary from petitioner of \$25,000. H. F. Boeger, George A. Mitchell, and William Fox were elected to the board of directors of petitioner at such meeting. These same individuals continued to serve as directors at the March 16, 1932 meeting. George A. Mitchell has continued to be employed by petitioner as engineer in charge of production and development. He was employed for a period of approximately five years from the date of incorporation at a salary of \$25,000 a year.

Messrs. Boeger and Mitchell entered into an agreement not to engage in or become interested directly or indirectly as individuals, partners, directors, officers, or employers, in any motion-picture camera business other than with the buyer, or with petitioner, for a period of five years from the date of the June 6, 1929 agreement.

During 1929 H. L. Clarke was the controlling stockholder of G.T.E.; was president of G.T.E., of Grandeur, and of petitioner.

For the taxable years 1939 and 1940, petitioner deducted on its returns as ordinary and necessary business expenses the respective amounts of \$11,161.88 and \$1,574.17 designated "New York Office Expenses," which the respondent disallowed. These expenditures constitute ordinary and necessary business expenses to the extent of \$10,255.11 for 1939 and \$1,050.65 for 1940.

Certain other expenditures made and entered on its books in 1939, 1940, and 1941, in the respective sums of \$1,637.49, \$1,583.71, and \$3,836.61, were ordinary and necessary expenses of the business.

OPINION

The principal issue is the basis for depreciation of certain patents acquired by petitioner in 1929 upon its organization and included in the aggregate of assets, tangible and intangible, constituting all the property and going business of Mitchell of California. Respondent asserts that basis to be \$1,180,157.59, while petitioner contends for a basis of \$2,860,178.95.

We have set out in our findings the facts in connection with the sale by Mitchell of California of all of its business and its acquisition by petitioner. Briefly stated, these facts are: Clarke and Fox had been associated in some work in developing a wide film camera know as "Grandeur." On May 24, 1929 they agreed in writing that a corporation would organized under the name of Grandeur, to engage in the business of "purchase, sale, lease and/or license of motion picture projectors, cameras and/or equipment or devices to be used in connection with motion picture projectors." This company was to pay out of its first earnings \$1,000,000 to Fox and \$500,000 to Clarke as reimbursement for their "expenditures, labor, overhead, and services for research work in the development of the wide film art."

On the next day a second agreement was executed by the parties, evidencing the fact that Clarke was

negotiating for the purchase of the business of Mitchell of California. In this instrument it was agreed that the purchase, if effected by him, was to be "for the benefit of a corporation to be organized by us—either independently operated by us or shall be wholly owned subsidiary of Grandeur, Inc."

Following this, Clarke negotiated the purchase of all the assets and business of Mitchell of California for an agreed consideration of \$1,475,000. The instrument effecting the conveyances were drawn to petitioner herein, and placed in escrow. Clarke deposited \$100,000 with the escrow agent and the balance of the purchase price was to be paid upon the delivery of the deeds and assignments. The deposit was furnished equally by Fox and Clarke. It constituted, so far as this record reveals, the only personal funds of these individuals used in the course of the series of involved transactions which followed.

Clarke and Fox caused three corporations to be organized, General Theaters Equipment, otherwise here referred to as G.T.E., Grandeur, and petitioner, Mitchell Camera Corporation. Clarke was president of all three corporations with authority to act for them and disburse their funds. [43]

On July 12, 1929, the day of the incorporation of petitioner, Clarke, as an individual, made an offer to petitioner to sell it the assets and business of Mitchell of California for \$3,100,000, which offer was accepted. Nothing was done toward closing the transaction with Mitchell of California until August 1, 1929. On that date G.T.E. came into possession

of \$11,400,000 in cash, from the sale of its securities. Arrangement had been made for its acquisition of several "lamp companies," not here involved. Clarke conducted the arrangement for these acquisitions. The sum of \$2,000,000 was paid by G.T.E. into Grandeur, for one-half of the latter's capital stock. Clarke had \$5,000,000 of G.T.E. funds paid into his personal bank account, which prior thereto had a balance slightly in excess of \$25,000. Thereupon Clarke "gave" Fox a check for \$2,000,000 of these G.T.E. funds, and Fox paid this amount into Grandeur, for the remaining one-half of its capital stock. Clarke then had Grandeur give petitioner its check for \$3,100,000 of the total of \$4,000,000 standing to its credit. For this Grandeur received in return all of the capital stock of petitioner. Thereupon Clarke had petitioner give its check for \$3,100,000 to him personally which he used to reimburse himself and Fox for their \$100,000 deposit and to pay the balance of \$1,375,000 due Mitchell of California for its assets and business.

Included in the assets acquired from Mitchell of California were some 30 patents and patent applications upon which patents were later issued. There is no evidence that in the negotiations or at any time in connection with the transactions effecting this purchase was any amount of the total purchase price allocated as paid for these patents. Petitioner now contends that outside of certain tangible assets of Mitchell of California, having an agreed value of \$239,821.05, there was nothing of value except the patents conveyed. It insists that Mitchell of

California had no good will or other intangible asset of any value and the only thing desired or considered as having value were the patents in question. It argues that the total consideration paid by petitioner, \$3,100,000, must be accepted as paid for all of the assets acquired, and to the patents there be allocated a cost of this amount less the agreed value of other tangible assets in the sum of \$239,821.05.

The record shows this is not the first occasion an investigation has been made to determine the actual basis to petitioner for depreciation purposes of the patents acquired in this transaction.

Petitioner in its statement of assets and liabilities attached to its first return filed for the period July 1 to December 31, 1929, reported patents as having a cost basis as of December 31, 1929 of \$52,961.28, and good will as having a cost basis of \$2,805,157.59. In that return it deducted depreciation on all depreciable assets in the sum of \$7,765.94. In the return for 1930, patents were reported as having the same basis, \$52,961.28, at the beginning of the year, and \$92,768.11 less a reserve for depreciation of \$42,028.91, or a net value of \$50,739.20 as of the close of the year. A value of \$2,805,157.59 was reported for "Goodwill, Franchise rights and Going Concern value" at both the beginning and end of the year. The return for 1931 reported the same value as from the first of \$2,805,157.59 for good will, franchise rights and going concern value and the patents at a basis of \$92,768.11 less a reserve for accumulated depreciation of \$42,028.91 or a net value

of \$50,739.20. These are the respective costs for good will and patents entered on petitioner's records upon their acquisition. Thus, the assumption is not unreasonable that these values reflected its then opinion of the relative value between patents and good will to be used as the basis of allocation to each of the total amount paid for the aggregate.

In 1932, upon audit of petitioner's returns for 1930 and 1931, deficiencies were proposed for those years. A controversy arose as to the correct portion of the total contract price allocable to the patents acquired. It is significant also that this controversy took place at a period when the transactions involving the acquisition of these assets and all of the details in connection therewith were fresh in the minds of the parties. All the records made available in the present proceeding were undoubtedly available to the officers and agents of petitioner and the respondent in that investigation. Conditions making for accurate determination existed then rather than now after the lapse of years.

As a result of this investigation and the conferences between the representatives of respondent and petitioner, the amount of the total cost to be ascribed to the patents in question was fixed as the amount at which Mitchell of California sold all of its properties, namely: \$1,475,000, less \$294,842.41, which was fixed as the value of the assets other than good will and patents. The resulting figure, \$1,180,157.59, was accepted by petitioner as the basis for computing depreciation upon its patents which, it was further agreed, should be depreciated upon the

average life method and upon a life of 12.3666 years. Upon this agreed basis, the depreciation deductible by petitioner was recomputed, resulting in a depreciation allowance of \$95,430.50 for each of those years as against the deductions of slightly over \$5,000 taken on its returns by petitioner in each of the years. [46]

Following this controversy, petitioner in each of the ensuing years used the same basis for depreciation of the patents and took the benefit of the deductions computed thereon. No question was raised as to the correctness of this basis until the taxable year before us. That correctness is now attacked because of the fact that respondent in determining the deficiency for the taxable year 1941 has computed the total depreciation "allowed or allowable" in prior years on the agreed basis of \$1,185,157.59 on an average life of 12.3666 years from July 27, 1929, the date of acquisition of the patents. This computation resulted in deductions for 1939, 1940, and 1941 of \$96,363.16, \$50,162.34, and \$1,027.78 as against the deductions taken on the returns of petitioner for those years of \$102,171.42, \$102,228.75 and \$94,605.94, respectively. The basis formerly agreed upon and used during the years having been exhausted, petitioner now seeks a larger basis and a different formula.

The burden, of course, is upon petitioner to show error in the basis for depreciation used by respondent in determining the deficiency. It would require very convincing proof here that the basis reached by the parties upon their investigation of the facts

at a time when all the circumstances were fresh in their memories and thereafter used for more than 10 years was incorrect. The evidence does not convince us that such basis was not a proper one. We do not agree that the assets and business of Mitchell of California had value represented only by its patents and certain other tangible property. Rather the evidence indicates to us that there was very substantial value in the good will and going business value of that concern. We cannot reconcile the statement that at the time the assets of Mitchell of California were acquired it was realized that such company had no good will or going business value with the fact that petitioner entered on its books a total amount of \$2,805,157.59 as representing what it had paid for these intangibles. Mitchell of California was a successful corporation operating a very prosperous business. The trade recognized that this company produced the best motion-picture cameras available. At the time of acquisition it had on hand a large backlog of unfilled orders. That its name was recognized in and as having value in the trade is shown, we think, by the fact that it was taken and used by petitioner.

Clarke purchased all the business and assets of Mitchell of California for the account of petitioner for an agreed consideration of \$1,475,000. That was the amount the seller received. This was an arm's length transaction and the only one, we think, which can be so characterized. The other transactions carried out by Clarke and Fox, through the three corporations they organized, were ones in which

the individual as such dealt with himself as president of a corporation. Thus it is evident to us that the price stated in the contract of purchase by petitioner might bear little, if any, relation to what actually was paid for the assets acquired, even though the full amount was paid from the treasury of the acquiring corporation. The manner in which the transaction was consummated does not establish the fact that petitioner actually paid \$3,100,000 for the assets it acquired. This record does not convince us that the indirect method used for carrying out the transaction was not merely a means of channeling certain proceeds from the sale of securities by G.T.E. to Clarke and Fox through their control of the corporations they organized. Certainly it is not established that the difference between the purchase price paid Mitchell of California and the \$3,100,000 actually paid by Clarke to himself from the funds of petitioner was paid as consideration for the assets. We hold that petitioner has not proved that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000. In this connection it is noted the contention is made that in addition to this amount large sums were paid as "commissions" in connection with the deals, and that these must necessarily be considered as additional cost. To whom they were paid or for what service rendered, we are not advised. These commissions are vaguely described as aggregating in amount somewhere between three hundred fifty and four hundred thousand. At a hearing before the Senate Committee on Banking and Currency,

the evidence was that \$100,000 was paid as commissions for the acquisition of not only the assets of Mitchell of California but of other corporations acquired by G.T.E. There was no showing that any part of this \$100,000 was paid in connection with the transaction here in question. We think more evidence than this is required upon which to base a finding of additional cost by reason of commissions paid. [49]

Petitioner contends that even if we find the actual cost to petitioner of the assets and business of Mitchell of California was only \$1,475,000, the computation under which the allocation of cost was originally made in the investigation in 1932 is subject to correction in one respect. It is pointed out that the amount of \$1,180,157.59 fixed by respondent as the cost of the patents was arrived at as the difference between \$1,475,000 and a value of \$294,842.41 assigned to net assets other than good will. Petitioner says it is here stipulated that the value of net tangible assets received from Mitchell of California was only \$239,281.05, and consequently a correct computation upon the basis used by the parties at that time would increase by \$55,021.36 the base then used for depreciation. This contention can not be sustained. That amount, \$294,842.41, was computed as the cost of net assets other than good will, whereas the value of \$239,821.05 which petitioner asks be substituted is the stipulated value of net tangible assets. We think the record amply demonstrates that intangible assets of substantial value exclusive of good will were received

among the assets acquired from Mitchell of California. One of these intangible assets was the agreements of the two organizers and operators of Mitchell of California not to engage in its line of business for a period of years. Another such asset was its large backlog of contracts. These might well have been worth the difference in the above two figures.

Petitioner further contends the formula used by it and by the respondent over all the years in computing allowable depreciation is incorrect. The patents in question, approximately 30 in number, had varying lives. Having been acquired as a whole, no basis existed for the allocation of an individual cost to each. Hence, the formula based on the average remaining life of the patents computed at 12.3666 years was used. It was [50] then apparent such formula would exhaust the depreciation basis of the aggregate of patents prior to the expiration of the longest-lived patent. Such formula has been consistently applied. Petitioner has taken depreciation each year upon such basis, thereby exhausting the entire basis prior to the taxable year. It now requests use of a formula approved in *Simmons Co.*, 8 B.T.A. 631. Petitioner argues that the only correct method of computing depreciation exhausts the basis ratably over the entire life of the asset and that this result is accomplished only by use of the formula approved in that case. In that case, the taxpayer had purchased 113 patents in one group. We there approved a deduction for depreciation for each year of that portion of the total cost which bore the same relation to such total cost as the life

of the patents which expired in each year bore to the total unexpired life of the group on the date of acquisition. It is urged our decision there must be construed as a disapproval of the average life formula here used. However, in the Simmons case, no dispute existed between the parties as to the formula used. We merely held that the agreed formula there used would be accepted since it appeared to result in that which the statute directed, namely: "reasonable allowance for depreciation."

The statute does not provide a formula. It appears to us that the use of the average life formula in the instant case results in a reasonable allowance. That was the view of the parties in adopting and using it consistently over the years. Petitioner in each such year has been allowed the deduction for depreciation thus computed. We have recognized [51] such formula as proper in other cases. Union Metals Mfg. Co., 4 B.T.A. 287; Prophylactic Brush Co., 25 B.T.A. 676; Syracuse Food Products Corp., 21 B.T.A. 865. Having taken this depreciation, petitioner cannot now, after the exhaustion of its basis, recompute its allowances according to another formula. *Virginian Hotel Corp. v. Helvering*, 319 U. S. 523.

In determining the deficiencies respondent disallowed certain deductions denoted "New York Office Expenses" for 1939 and 1940 and "Special Expenses" for 1939, 1940, and 1941. We have found the correct amounts of these items for each year and that they were ordinary and necessary business expenses. It follows that such amounts are deduc-

tible. Section 23, I.R.C. The total of these expense deductions claimed for 1939 has been reduced by \$100 as constituting not an expense but a donation to the Hebrew Aid Society and no deduction for such contribution is permissible since petitioner had no net income in 1939. Section 23, I.R.C.

Decision will be entered under Rule 50.

Entered June 24, 1947.

[Seal]

The Tax Court of the United States
Docket No. 8058

MITCHELL CAMERA CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Memorandum Findings of Fact and Opinion of the Court entered in the above-entitled proceeding June 24, 1947, the respondent having filed his computation on August 26, 1947, and the petitioner having filed its acquiescence therein on September 4, 1947, it is

Ordered and Decided that for the year 1941 there is a deficiency in income tax of \$47,720.78, and no deficiency in declared value excess-profits tax.

Entered Sept. 9, 1947.

[Seal] /s/ J. RUSSELL LEECH,
Judge.

[Title of Tax Court and Cause.]

MOTION TO VACATE AND SET ASIDE THE
MEMORANDUM FINDINGS OF FACT
AND OPINION

Comes now the petitioner, Mitchell Camera Corporation, by Harry Friedman, its counsel, and moves the Tax Court of the United States to vacate and set aside its memorandum findings of fact and opinion entered June 24, 1947, and in support of said motion states as follows:

1. That the Tax Court of the United States is an agency of the Government of the United States within the meaning of Section 2 of the Administrative Procedure Act (Chapter 324—Public Law 404) and James Russell Leech, Judge of the Tax Court of the United States, is the presiding officer of that agency within the meaning of Sections 7 and 8 of the Administrative Procedure Act. See *The Lincoln Electric Co. vs. Commissioner*, Sixth Circuit Court of Appeals—decided June 5, 1947. (1947 CCH Tax Reporter, Paragraph 9282.)

2. That on October 22nd and 23rd, 1946, a hearing was held in Docket No. 8058 at Washington, D. C., which hearing was presided over by said James Russell Leech, Judge of the Tax Court of the United States. [54]

3. That on June 25, 1947, petitioner, through its counsel, received a copy of the memorandum findings of fact and opinion in Docket No. 8058

dated June 24, 1947, by United States mail from the said Court.

4. That said memorandum findings of fact and opinion dated June 24, 1947, was an initial decision of the said Court within the meaning of Section 8 (a) of the Administrative Procedure Act, but was served on petitioner without notice and without giving petitioner a reasonable time to submit its objections and exceptions to said initial decision together with its reasons in support of said objections and exceptions, pursuant to Section 8 (b) of the Administrative Procedure Act.

Wherefore petitioner prays:

(1) That the memorandum findings of fact, heretofore entered herein dated June 24, 1947, be withdrawn.

(2) That petitioner be granted a reasonable time to file its objections and exceptions to the proposed findings of fact and opinion, pursuant to the Administrative Procedure Act.

Dated: July 23, 1947.

/s/ HARRY FRIEDMAN,
Counsel for Petitioner.

Filed July 24, 1947.

[Endorsed]: Denied July 25, 1947.

/s/ J. RUSSELL LEECH,
Judge.

In the United States Circuit Court of Appeals
for the Ninth Circuit

T. C. Docket No. 8058

MITCHELL CAMERA CORPORATION,
Petitioner on Review,
vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

PETITION FOR REVIEW AND ASSIGN-
MENTS OF ERROR

To the Honorable Judges of the United States
Circuit Court of Appeals for the Ninth Circuit:

Now comes the Mitchell Camera Corporation by
its attorneys, Harry Friedman and Birger Tinglof
and respectfully shows:

I.

Jurisdiction

That the petitioner on review is a Delaware corporation organized on July 12, 1929, with principal office at 665 North Robertson Boulevard, Los Angeles, California, that it filed its federal tax returns for the year 1941 with the Collector of Internal Revenue for the Sixth District of California, Los Angeles, California; whose office is within the jurisdiction of this Honorable Court; that the respondent on review is the duly appointed, qualified, [56] and acting Commissioner of Internal Revenue, hereinafter referred to as the Commis-

sioner, appointed and holding his office by authority of the laws of the United States; that the Court in which the review of this cause is sought is the United States Circuit Court of Appeals for the Ninth Circuit.

Petitioner files this petition for review pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II.

Nature of Controversy

On February 27, 1945, the Commissioner of Internal Revenue mailed to the petitioner a notice of deficiency in income and declared value excess profits taxes for the year 1941 in the amounts of \$71,301.66 and \$2,177.28, respectively. The determination of the correct net taxable income of petitioner for the year 1941 requires the ascertainment of its correct net taxable income for the calendar years 1939 and 1940 because of the carry-over net losses applicable to those years. The deficiencies asserted were based on partial disallowance of the depreciation claimed on patents, and disallowance of certain "special expenses" and New York office expenses for the years involved.

The Mitchell Camera Company of California (hereinafter referred to as Mitchell of California) for a number of years prior to 1929 was engaged in the business of manufacturing professional motion picture cameras and accessories for the large motion picture studios in California. All of

its business was in patented products manufactured under patents which it owned. In 1929 the introduction of "sound" motion pictures revolutionized the motion picture industry and Mitchell of California became the sole supplier of cameras for the major motion picture studios. This was due to the fact that under its patents it produced a relatively noiseless camera in comparison with that of its competitors. Because of the patented features of the Mitchell camera it was [57] practically impossible to use any other camera in the production of "sound" motion pictures.

On June 6, 1929, Harley L. Clarke, entered into a contract to purchase the assets of Mitchell of California for \$1,475,000.00, part of which was to be paid in cash and the balance in stock. The terms of this contract were changed, and Clarke instead paid to the stockholders of Mitchell of California, the sum of \$1,475,000.00 in cash. Clarke testified in the Tax Court, as a witness for the Commissioner, that he paid an additional sum of \$350,000.00 to \$400,000.00 in commissions on this purchase, making the total cost of the property to him at least \$1,825,000.00.

On July 16, 1929, petitioner's Board of Directors accepted a proposal submitted by Clarke to sell to petitioner, for \$3,100,000.00 in cash, all of the property which he had acquired from Mitchell of California. Thereafter, Clarke caused said property to be delivered to petitioner, and petitioner paid to Clarke, in consideration therefor, the sum of \$3,100,000.00.

On May 15, 1945, petitioner filed a petition with the Tax Court of the United States appealing from the deficiency asserted by the Commissioner. The Commissioner filed his answer on June 20, 1945, and the case came on for hearing before Judge Leech in Washington, D. C., on October 22nd and 23rd, 1946. Petitioner filed an amended petition on November 4, 1946, to which the Commissioner filed his answer on November 18, 1946.

On June 24, 1947, the Tax Court entered its opinion, in which it generally sustained the petitioner's contentions with respect to the special expense and New York office expense items, but ruled for the Commissioner on the depreciation issues. On July 24, 1947, the petitioner by motion requested the Tax Court to vacate and set aside its findings of fact and opinion on the ground that the Tax Court is an agency of the United States within the meaning of [58] Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and that petitioner was given no opportunity as required by that Act to submit objections or file exceptions to the said opinion, or "initial decision," prior to its issuance. The motion was denied on July 25, 1947.

On August 26, 1947, the Commissioner filed a computation in compliance with the opinion of the Tax Court, in which he reduced the asserted income tax deficiency of petitioner for the year 1941 to \$47,720.78, and eliminated the deficiency in declared value excess profits tax. Petitioner acquiesced in this computation, subject to right of appeal. The

Tax Court entered its final decision in the case on September 9, 1947, wherein it ordered and decided that there is a deficiency in income tax of \$47,720.78, and no deficiency in declared value excess profits tax.

The principal issue in this case concerns the basis for depreciation of the patents which petitioner purchased from Harley L. Clarke, and which he in turn had purchased from Mitchell of California. It is petitioner's position that the proper basis for depreciation of these patents is \$2,860,-178.95, representing the \$3,100,000.00 which it paid Clarke for the assets formerly owned by Mitchell of California, less \$239,821.05 which is the agreed value of the tangible assets. The Commissioner contends that the basis of the patents to petitioner is \$1,180,157.59, representing the \$1,475,000.00 which Clarke paid to Mitchell of California for its assets, less \$294,842.41 which is claimed to be the cost of the assets other than goodwill.

Other issues concern whether depreciation should not be spread over the entire statutory life of the patents, rather than computed on an average life basis as was done by the Commissioner; whether, if cost to Clarke is to be considered the basis to petitioner, there should not be added to such basis the commissions which Clarke paid in order to acquire the assets from Mitchell of [59] California; whether the basis of the patents should not be adjusted to reflect the amount of annual depreciation which, on Commissioner's theory would be correct, where petitioner because of mathematical

error took depreciation in excess of that amount for the years 1932-1938, but this resulted in its receiving no tax benefit except for the year 1936; whether the stipulated value of the net tangible assets is not the correct figure which should be deducted from the total cost of the assets in arriving at the cost basis of the patents.

III.

Assignments of Error

The petitioner, being aggrieved by the findings of fact and conclusions of law contained in the decision of the Tax Court of the United States and by its final order determining a deficiency in income tax of \$47,720.78 for the year 1941 desires to obtain a review by the United States Circuit Court of Appeals for the Ninth Circuit.

The petitioner's assignments of error are as follows:

1. The Tax Court erred in not holding and deciding that the cost to petitioner of the assets and business of Mitchell of California was \$3,100,000.00.

2. The Tax Court erred in not holding and deciding that the correct basis for depreciation of the patents which petitioner acquired when it purchased the assets and business of Mitchell of California was \$3,100,000.00 less the agreed value of the tangible assets.

3. The Tax Court erred in holding and deciding that petitioner did not prove that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000.00.

4. The Tax Court erred in holding and deciding that the basis for depreciation of patents which petitioner purchased from Harley L. Clarke is to be determined by reference to the price which Clarke paid to Mitchell of California for its business and assets. [60]

5. The Tax Court erred in holding and deciding that the assets of Mitchell of California acquired by petitioner included substantial value in goodwill and intangibles other than patents.

6. The Tax Court erred in holding and deciding that the Commissioner might properly compute depreciation on the group of patents acquired by petitioner on the basis of the average life of the patents, rather than by spreading depreciation over the entire life of all the patents.

7. The Tax Court erred in not holding and deciding that depreciation on a group of patents with varying lives should be computed by allowing in each year as depreciation that portion of the total cost of the group of patents which bears the same relation to the total cost as the life of the patents expiring in each year bears to the total unexpired life of the group on the date of acquisition.

8. The Tax Court erred in not holding and deciding that the \$350,000 to \$400,000 which the Government witness, Harley L. Clarke, testified without contradiction that he paid as commissions to acquire the assets of Mitchell of California must be added to Clarke's cost of the assets if such cost is to be treated as the cost of the assets to petitioner.

9. The Tax Court erred in not holding and deciding that, where petitioner through error took depreciation for the years 1932 through 1938 in excess of the amount which on Commissioner's theory would be correct, but except for the year 1936 received no tax benefit as a result, the basis for computing depreciation for the years in controversy should be adjusted to reflect the correct amount of depreciation for earlier years.

10. The Tax Court erred in holding and deciding that a figure other than the stipulated value of the net tangible assets might be deducted from the total cost of the assets formerly owned by Mitchell of California in arriving at the cost basis to petitioner of the patents included in such assets. [61]

11. The Tax Court erred in entering its final order and decision that there is a deficiency in petitioner's income tax for the year 1941 of \$47,720.78.

12. The Tax Court erred in that its decision is not supported by the evidence.

13. The Tax Court erred in that its decision is contrary to the law and regulations.

14. The Tax Court erred in denying petitioner's motion to set aside its memorandum findings of fact and opinion for the reason that the Tax Court is an agency of the United States within the meaning of the Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and petitioner was given no opportunity as required by that Act to submit objections or to file exceptions to said opinion or "initial decision" prior to its issuance.

Wherefore petitioner prays that the decision of the Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit, that a transcript of record be prepared in accordance with the rules of said Court and transmitted to the Clerk of said Court for filing, and that proper action be taken to the end that the errors complained of may be reviewed by said Court.

/s/ HARRY FRIEDMAN,
/s/ BIRGER TINGLOF,
Attorneys for Petitioner.

District of Columbia—ss.

Harry Friedman, being duly sworn, deposes and says:

I am one of the attorneys for the petitioner in this proceeding; I have read the foregoing petition and am familiar with the contents thereof. The statements contained therein are true to the best of my knowledge, information and belief. This petition is not filed for the purpose of delay and I believe the petitioner is justly entitled to the relief sought.

/s/ HARRY FRIEDMAN.

Subscribed and sworn to before me this 29th day of October, 1947.

[Seal] /s/ FRANK E. ELDER,
Notary Public.

Filed T.C.U.S. Nov. 3, 1947. [63]

[Title of Circuit Court of Appeals and Cause.]

NOTICE OF FILING PETITION
FOR REVIEW

To: Commissioner of Internal Revenue, Internal
Revenue Building, Washington, D. C.

Charles Oliphant, Esq., Chief Counsel, Bureau of
Internal Revenue, Washington, D. C.

You are hereby notified that the Mitchell Camera Corporation did on the 3rd day of November, 1947, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit, of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the Petition for Review and the Assignments of Error as filed is hereto attached and served upon you.

Dated: November 3, 1947.

/s/ HARRY FRIEDMAN,

Attorney for the Petitioner.

Personal service of the above and foregoing notice, together with a copy of the Petition for Review and assignments of error mentioned therein, is hereby acknowledged this 3rd day of November, 1947.

/s/ CHARLES OLIPHANT, OWS

Chief Counsel, Bureau of
Internal Revenue.

Filed T.C.U.S. Nov. 3, 1947. [64]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS

Now comes the Mitchell Camera Corporation, the Petitioner on Review herein, by its attorneys, Harry Friedman and Birger Tinglof, and hereby asserts the following errors on which it intends to rely in this review:

1. The Tax Court erred in not holding and deciding that the cost to petitioner of the assets and business of Mitchell of California was \$3,100,000.00.

2. The Tax Court erred in not holding and deciding that the correct basis for depreciation of the patents which petitioner acquired when it purchased the assets and business of Mitchell of California was \$3,100,000.00 less the agreed value of the tangible assets.

3. The Tax Court erred in holding and deciding that petitioner did not prove that its actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000.00.

4. The Tax Court erred in holding and deciding that the basis for depreciation of patents which petitioner purchased from Harley L. Clarke is to be determined by reference to the price which Clarke paid to Mitchell of California for its business and assets.

5. The Tax Court erred in holding and deciding that the assets of Mitchell of California acquired by petitioner included substantial value in [65] goodwill and intangibles other than patents.

6. The Tax Court erred in holding and deciding

that the Commissioner might properly compute depreciation on the group of patents acquired by petitioner on the basis of the average life of the patents, rather than by spreading depreciation over the entire life of all the patents.

7. The Tax Court erred in not holding and deciding that depreciation on a group of patents with varying lives should be computed by allowing in each year as depreciation that portion of the total cost of the group of patents which bears the same relation to the total cost as the life of the patents expiring in each year bears to the total unexpired life of the group on the date of acquisition.

8. The Tax Court erred in not holding and deciding that the \$350,000 to \$400,000 which the Government witness, Harley L. Clarke, testified without contradiction that he paid as commissions to acquire the assets of Mitchell of California must be added to Clarke's cost of the assets if such cost is to be treated as the cost of the assets to petitioner.

9. The Tax Court erred in not holding and deciding that, where petitioner through error took depreciation for the years 1932 through 1938 in excess of the amount which on Commissioner's theory would be correct, but except for the year 1936 received no tax benefit as a result, the basis for computing depreciation for the years in controversy should be adjusted to reflect the correct amount of depreciation for earlier years.

10. The Tax Court erred in holding and deciding that a figure other than the stipulated value of the

net tangible assets might be deducted from the total cost of the assets formerly owned by Mitchell of California in arriving at the cost basis to petitioner of the patents included in such assets.

11. The Tax Court erred in entering its final order and decision that there is a deficiency in petitioner's income tax for the year 1941 of \$47,720.78.

12. The Tax Court erred in that its decision is not supported by the evidence.

13. The Tax Court erred in that its decision is contrary to the law and regulations.

14. The Tax Court erred in denying petitioner's motion to set aside its memorandum findings of fact and opinion for the reason that the Tax Court is an agency of the United States within the meaning of the Administrative Procedure Act (Chapter 324, 60 Stat. 237, Title 5, Ch. 19 USCA), and petitioner was given no opportunity as required by that Act to submit objections or to file exceptions to said opinion or "initial decision" prior to its issuance, or to obtain review by the Tax Court of the report of the Judge who heard the case.

/s/ HARRY FRIEDMAN,

/s/ BIRGER TINGLOF,

Attorneys for Petitioner.

Service of a copy of the within statement of points is hereby admitted this 2nd day of January, 194...

/s/ CHARLES OLIPHANT, CAR

Chief Counsel, Bureau of
Internal Revenue.

Filed T.C.U.S., Jan. 2, 1948. [67]

[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF EVIDENCE

The above-entitled proceedings came on for hearing on October 22nd and 23rd, 1946, before the Honorable J. Russell Leech, Judge of The Tax Court of the United States. The Petitioner appeared by its attorney, Harry Friedman, Esquire, and the Respondent appeared by his attorney, E. M. Woolf, Esquire.

The proceedings were heard on a stipulation of facts, oral testimony and documentary evidence. All of the oral testimony introduced which is material and necessary for the determination of the assignments of error set out by the Petitioner on Review in his petition for review by this Court of the decision of the Tax Court, is set out herein in narrative form.

Statement of Case on Behalf of Petitioner
By Mr. Friedman:

If your Honor please, this is the petition of the Mitchell Camera Corporation, a Delaware corporation, organized in July, 1929. The taxable year involved is the year 1941, but issues are raised as to the years 1939 and 1940, [68] as well as 1941, because of the net operating loss carried over for those two years, which affects the tax year 1941. The deficiency involved is \$71,301.66 in income taxes and \$2,177.28 in declared value excess profit taxes for the year 1941.

The case involves two sets of issues, the first one being what we might call the patent issue. The

controversy with respect to the patents arises out of the purchase by Mr. H. L. Clarke under an agreement of July 6, 1929, of all the property of a California corporation of the same name, Mitchell Camera Corporation. And I think it might be better for the sake of clarity to refer to that as the California corporation, and the Petitioner as the Delaware corporation.

The evidence will show that Mr. Clarke purchased the property of the California corporation for \$1,475,000.00 in cash, and that he sold that property to the Petitioner shortly thereafter for \$3,100,000.00 in cash. There is no controversy over those facts at that point.

The California corporation for a number of years prior to 1929 was engaged in the business of manufacturing motion picture cameras for the large motion picture producers in southern California. Its product was protected by a number of patents, about thirty patents, which we have here. The superiority of the Mitchell camera depended entirely upon these patented features.

The evidence will show that without these patents there would have been no Mitchell camera, nor a Mitchell Camera Corporation, because anyone owning the patents would control the business of making the Mitchell camera.

The property purchased by Clarke and later resold to the Petitioner was offered to the Petitioner in a proposal which provided that he would sell to the Petitioner all of the business, property and assets of the California corporation. [69]

The tangible assets consisted of inventories, a small accounts receivable, land and building and a small piece of other land, which we are in agreement on had a fair market value at that time of \$239,821.05. There is no controversy over the value of the tangible assets. There is a little difference. In the deficiency letter the Commissioner used as the value of the tangible assets a figure of \$294,841.41, instead of the figure we have now stipulated, \$239,821.05.

The issue with respect to the patents arises out of the balance of the purchase price, the difference between the \$3,100,000.00 and the \$239,000. The question there is whether that difference is to be allocated to patents, the backbone of the California corporation and the only other asset the California corporation had, or to something else, good will or other intangibles, whatever the Commissioner might claim.

The Commissioner in this case has done this: He has based our patent cost on the cost paid by Mr. Clarke to the owners of the California corporation, rather than the cost which we paid to Mr. Clarke. He has taken the \$1,475,000 which Mr. Clarke paid, applied against that the value of the tangible assets, and attributed the balance to patents. We say in that he has erred, that our cost was the \$3,100,000.00, irrespective of what Mr. Clarke may have paid for the property prior to the time he sold it to the Petitioner.

The transaction was one transaction in a series of transactions involving the formation of the General Theatres Equipment Company, and I think the

Government will attempt to bring that transaction into the case. We will attempt to show that that has nothing to do with our particular problem.

We have stipulated that after your decision on those issues, the question of the amount of net carry-over from 1939 and 1940 to 1941 may be settled under Rule 50 of this Court. [70]

Statement of Case on Behalf of Respondent

By Mr. Woolf:

May it please your Honor, the principal issue involved here, the cost or basis of the patents acquired by the Petitioner corporation, is not as simple as counsel for the Petitioner seems to think, insofar as the Respondent has developed the facts. I would like to make a short statement of the facts that the Respondent will admit and I feel which we will present at the hearing.

In the early part of 1929, Mr. Clarke was engaged, among other things, in the theatre supply business. He owned or controlled the International Projector Corporation, and I think at that time there was contemplated organizing a corporation, which was later organized, and which was known as General Theatres Equipment, Incorporated. Mr. Clarke, on behalf of himself or on behalf of this new corporation, was anxious to acquire four so-called lamp companies. They will be brought out,—the names of them will be brought out in the testimony. He was also anxious to acquire, for himself or on behalf of G.T.E., the Mitchell Camera Corpo-

ration of California, which owned the patents, or the stockholders owned the patents or patent rights at that time.

Mr. Clarke, I believe, had several conversations with Mr. William Fox, who at that time either owned or controlled Fox Film Corporation and Fox Theatre Corporation among other corporations that were owned or controlled by Fox or the Fox family.

There was some discussion as to whether they would acquire these corporations or companies jointly, and whether both parties would have an interest therein, or just how the transaction should be handled.

There were several letters exchanged about May 24, 1929,—May 25, 1929, and I believe Mr. Fox about that time put up \$50,000.00. The Mitchell Camera Corporation of Delaware was to be organized,—the Petitioner here,—and that corporation was to hold the patents and all of the properties of the [71] old Mitchell Camera Company of California.

A corporation by the name of Grandeur, Incorporated, was to be organized. Grandeur, Incorporated, was to own all of the stock of the Petitioner. General Theatres Equipment was to own one-half of the stock of Grandeur, and it later developed that Mr. William Fox owned the other half of Grandeur.

There is some question just how the transaction was handled, as the checks for acquiring the properties all went the same day, August 1st or 2nd, 1929. In the meantime, Mr. Clarke acquired the

four lamp companies, and also acquired the properties, assets, patents and patent applications of the Mitchell Camera Company of California.

The General Theatres Equipment on August 1, 1929, sold stock and bonds, or securities, for which it received \$11,400,000.00. Of that fund, our information discloses that five million dollars was allocated for Mr. Clarke to acquire the four lamp companies and one-half of the Grandeur stock.

There was some agreement between Mr. Clarke and Mr. Fox whereby he was to receive this one-half interest in Grandeur, Incorporated. So Mr. Clarke acquired Mitchell Camera Company's assets, patents and patent applications for \$1,475,000.00. I do not believe he ever acquired possession of the assets, but the assets were transferred to the Mitchell Camera Corporation of Delaware, the Petitioner contends for \$3,100,000.00. That transaction took place within six weeks or so at the time that Mr. Clarke acquired those assets.

On August 1, 1929, Mr. Clarke gave Mr. Fox a check—two checks—one for \$1,625,000.00 and one for \$375,000.00, making a total of \$2,000,000.00. Mr. Fox gave a check to Grandeur, Incorporated, for \$1,950,000.00, and I believe the difference there was the credit of \$50,000 which he had already put up with Mr. Clarke, for which he was to receive one-half of the outstanding stock of the Grandeur corporation. [72]

Now Mr. Clarke, on behalf of General Theatres Equipment, which corporation was to acquire the other half of Grandeur, Incorporated, paid into

Grandeur, or gave credit to Grandeur, of \$2,000,000.00. So Grandeur had four million dollars August 1st or August 2nd, 1929.

I am not quite sure whether the \$3,100,000.00 was paid by Grandeur directly back to Mr. Clarke, or whether it went into the Mitchell Camera Corporation of Delaware, the Petitioner here, and then on the same day to Mr. Clarke, but the way it ended, Grandeur had a working capital, had cash, which we will show by the balance sheet attached to the return, of \$900,000.00. Grandeur in addition owned all the capital stock of the Mitchell Camera Corporation, the Petitioner.

Mitchell Camera Corporation didn't keep any of the three million, one hundred thousand. If they received it, they received it with the agreement that they would immediately transfer it over to Mr. Clarke. So the Respondent's position as to the cost basis is simply this: ,

The assets and the properties, the patents and the patent applications, were acquired by Mr. Clarke, as shown in the Deficiency Letter for \$1,475,000.00. Then a short period before he ever took possession of those properties they were transferred to the new corporation at a stepped-up basis of \$3,100,000.00.

General Theatres Equipment only had \$5,000,000.00 to acquire the four lamp companies and Grandeur. The money, that part of the five million dollars which was allotted to acquire Mitchell, went around in a circle and came back to Clarke, who was acting on behalf, I think, of G.T.E. Mr. Fox

was given a one-half interest in the Grandeur corporation—what the consideration was will be developed at the hearing—and the cost of the patents to Petitioner was the difference between the \$1,475,000.00 and the tangible assets, or as [73] shown in the Deficiency Letter, \$1,180,157.59.

Grandeur, Inc., filed consolidated returns with Mitchell Camera Corporation for a few years. In 1934 the question arose as to the years of 1930 and 1931 as to the basis of the patents. Now, conferences were held, protests were filed. The Petitioner submitted their facts. At that time it was agreed that the cost basis of the patents was \$1,180,157.59.

The Court: Cost basis to whom?

Mr. Woolf: To the Petitioner.

The Court: Who made the agreement?

Mr. Woolf: The Petitioner and the Bureau of Internal Revenue. In settling the deficiency for the years 1930 and 1931, they accepted that basis and it went on to the year 1941. The first time the question came up was in 1941, as to the new basis now claimed by the Petitioner.

The Respondent respectfully submits that the facts clearly show what the cost basis to the Petitioner was. At the time the case for 1930 and 1931 was settled, there was also a question as to the rate that the patents were to be depreciated or amortized. The petitioner contended that it was 12.366 years. In the petition, there is an allegation that the Commissioner erred in that allocation. I do not believe Mr. Friedman mentioned that this morning.

Mr. Friedman: I just overlooked it.

Mr. Woolf: In the event there is an attempt to change the method of allocation, which now he wants to put on a so-called monthly basis, that there were so many patents in existence during the taxable year, and so many months, Respondent takes the position that it will be necessary for him to allocate the cost basis that he claims for all of the patents against each patent, in order that we may determine the proper depreciation for the years 1939, 1940 and 1941. The only year involved is 1941, but there are carry-overs from the other two years.

The Court: Just a minute. What rate did Respondent apply in determining depreciation?

Mr. Woolf: The respondent accepted the Petitioner's contention that the cost of the patents was \$1,180,000 plus, and that they should be depreciated over 12.366 years.

The Court: As an aggregate?

Mr. Woolf: As an aggregate.

The Court: Now, as we understand, on this depreciation issue the Petitioner contends that its basis for the purpose of computing depreciation is the cost of these patents to the Petitioner, which they say is three million and odd dollars. As we understand, that figure is conceded by the Respondent, is that so, that the Petitioner actually paid—

Mr. Woolf: No, your Honor.

The Court: The statement was made, as we recall it, in the opening statement by counsel for the Petitioner, that that was conceded. You see, what we want to get at here, is the basis for depreciation, except for certain exceptions. Is that so?

Mr. Woolf: Cost of patents.

The Court: That is right.

Mr. Woolf: That is right.

The Court: Now, cost would be the basis here, unless one of the exceptions should apply, and I am trying to determine here as to which one or more of those exceptions the Respondent says these facts put the Petitioner in. Do you follow my question?

Mr. Woolf: Yes, your Honor. It is the position of the Respondent, first, that the petitioner did not pay three million, one hundred thousand dollars for the patents. It didn't have three million, one hundred thousand dollars to pay for all of the assets, including the tangible assets, and, which has not been mentioned here, good will, patents and tangible assets. [75]

It is the Respondent's position it is merely a stepped-up basis from one million four hundred and seventy-five thousand to three million, one hundred thousand; that the difference merely went back to Mr. Clarke, who really originally acquired the properties, and the Petitioner corporation never had that amount to acquire the patents.

The Petitioner set the properties up on its books and attributed \$2,805,000.00 to good will on the books. So the Respondent takes the position, first, that it didn't have three million one hundred thousand to pay for patents; that Mr. Clarke on behalf of G.T.E. received back the three million one hundred thousand, of which two million had just passed through Mr. Fox for the purpose of giving him a

half interest in the Grandeur corporation.

The Court: Well, then, it is your position that as a matter of fact the Petitioner did not pay this three million odd dollars for the patents; secondly, if it did pay it, that part of it was properly allocable to something other than patents?

Mr. Woolf: Good will, or something else—what Mr. Fox acquired.

The Court: Have I stated that rightly?

Mr. Woolf: That is correct.

Supplemental Statement on Behalf
of Petitioner

Mr. Friedman: I should like to supplement the opening statement on this question of the basis of apportioning depreciation. The Commissioner has used the average life method, 12.366 years. Our position is that that exhausts the patent base or cost, whatever it might be, prior to the expiration of the life of the patents, and therefore is not a proper basis; that the correct basis of allocation is that set by this Court in the Simmons case, 8 B.T.A. 621, where the patents were depreciated over their full life. You took the total number of months of the life of the patents and made a fraction. On top you used the number of months which expired within the taxable year. Here the total life of the patents is 4452 months. 212 months expire within one taxable year, so [76] the proper depreciation for that year would be 212 over 4452.

Now on the question of this prior agreement, which your Honor has just heard, it is not the tax-

payer who is really repudiating that agreement, if there was such an agreement, because in this case under the 1934 settlement the life of the patents would expire some time in the year 1941, and we would be entitled to depreciation on those patents on whatever basis we had through the year 1941.

Now in the Deficiency Letter, as your Honor will notice, we are allowed the depreciation for 1939, we are allowed approximately half of it for 1940, and we are allowed none of it for 1941.

The Commissioner reaches that result by taking as the depreciation allowed for prior years the amounts we erroneously took on some of our returns in those years, but we have not gotten credit for tax purposes for our real base even on the Commissioner's idea.

Further with respect to the settlement, it was not a closing settlement of any kind. Of course, if it is wrong it can be corrected by either the Respondent or the Petitioner. It is not *res adjudicata* in this case.

The Court: Well, we do not understand it is being contended it is *res adjudicata*. Is that your contention?

Mr. Woolf: No, your Honor, we have not pleaded *res adjudicata*.

The Court: We notice no plea of *res adjudicata*, and obviously there was no basis for such a plea. You have a stipulation.

(Thereupon the Court received and filed the stipulation of the parties, with Petitioner's Exhibits 1-10, inclusive, attached.)

Mr. Friedman: If your Honor please, as you will see from the stipulation, Mr. Clarke made an offer to the Mitchell Camera of Delaware on July 12, [77] 1929——

The Court: Where are you reading from?

Mr. Friedman: Exhibit 1, your Honor. Made an offer to the Mitchell Camera Corporation of Delaware on July 12, 1931——

The Court: 1929.

Mr. Friedman: 1929, offering to sell to that corporation all of the properties, business and assets of the Mitchell Camera Company, the California corporation. And your Honor will see in the next to the last paragraph that: "In consideration of the foregoing you shall pay to or upon the order of the undersigned the sum of \$3,100,000 in cash."

That offer was presented to the Board of Directors. You will see that on Exhibit No. 2. That offer was presented to the Board of Directors of the Mitchell Camera Corporation of Delaware at a meeting held on July 16, 1929. That is beginning the last paragraph on the second page of Exhibit 2. "The Chairman then stated that there had been received the following proposal from Mr. H. L. Clarke," and the proposal of July 12th follows.

Then at the top of the next page, that proposal was accepted by resolution, which reads: "Resolved that the foregoing proposal be, and the same is, hereby accepted, and the proper officers of this Corporation be and they are hereby authorized and directed to execute any and all checks, documents or papers necessary or proper to carry this resolution into effect."

Then there follows a resolution under which the Grandeur Company purchased the stock of the Mitchell Camera Company for \$3,100,000 in cash. I believe the Government has the check which was paid for that stock. There is no question about the \$3,100,000 having been paid in to the Mitchell Camera Corporation and having been paid out of the Mitchell Camera Corporation—no question. [78]

Mr. Woolf: On the part of the petitioner, your Honor.

Mr. Friedman: Well, the proof shows it. Then the stipulation shows the documents under which the property was transferred to Mitchell Camera Corporation, the assignments of patents. Then we have stipulated a list of patents, together with the expiration dates, and the total number of unexpired months of life. That is Exhibit 8, your Honor. Those are the assignments you have there, 5, 6, 7 and 8. Exhibit 8 is a list of patents with the patent numbers, the dates of expiration, the term in years, the number of months which expired prior to December 31, 1938, and the number of months which expired in each one of the taxable years, 1939, 1940 and 1941. You will see that some of those patents do not expire until 1948, 1949, 1943, 1950 and so on, beyond the year 1941.

And then we also have stipulated here the copy of agreement under which Mr. Clarke purchased the property from Mr. George A. Mitchell and Mr. H. F. Boeger, the owners of the California corporation.

If your Honor please, I should like to offer in

evidence the Patent Certificates referred to in the stipulation.

The Court: Is there objection?

Mr. Woolf: May I see them? (Same were shown to counsel.) No objection, your Honor.

The Court: As we notice from the stipulation, the last identified exhibit attached to the stipulation is Exhibit 10. Is that right?

Mr. Friedman: Yes, your Honor, No. 10.

The Court: This exhibit will be identified as Petitioner's Exhibit No. 11, and received as such.

(The documents above referred to were received in evidence and marked Petitioner's Exhibit No. 11.) [79]

Mr. Friedman: I should like to call Mr. George A. Mitchell.

GEORGE A. MITCHELL

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Friedman:

I reside in Pasadena, California. I have been connected with the motion picture camera business since 1912. I am employed by the Petitioner as Engineer in Charge of Production and Development. In 1929 and prior thereto I was a stockholder and officer of the Mitchell Camera Corporation of California. In June 1929 I owned a $\frac{1}{3}$ interest in

(Testimony of George A. Mitchell.)

the Mitchell Camera Corporation of California and Henry F. Boeger owned the other $\frac{2}{3}$ rds. I was engineer in charge of production and development of the California corporation. I am the inventor named in the various patents shown in Petitioner's Exhibit No. 11. In 1929, Mr. Boeger and I sold our interest in the Mitchell Camera Corporation to H. L. Clarke. We both continued with the new company after we sold out. I was engaged as engineer in charge of production and development, the same position I had before. In 1929 the Mitchell Camera Corporation of California manufactured professional motion picture cameras used by studios. The new company continued in the same business. Its products were protected by patents on inventions owned by me or the corporation. All of the company's business was in patented products. In 1929 the company's principal customers were the major studios producing pictures. The studios started to become important customers of Mitchell Camera Corporation about the year 1927 when sound came into the picture business. We were fortunate enough to have a camera that was very quiet, compared to others. So far as I know the studios in 1929 did not purchase any cameras other than ours. We had the only camera which could be [80] used with sound so we became flooded with orders. In 1929 we were far behind in meeting our orders.

We attribute the position of the Mitchell Camera Corporation in 1929 to patents. We had patent protection on our products. The business of Mitchell

(Testimony of George A. Mitchell.)

Camera Corporation was based upon its patents. Good will was not a factor in the business in 1929.

Mr. Clarke did not have any interest in the Mitchell Camera Corporation of California prior to the time he entered into the contract to buy it. Mr. William Fox did not own any stock in the Mitchell Camera Corporation of California.

Cross-Examination

By Mr. Woolf:

Q. Mr. Mitchell, when were you first approached in regard to the sale of Mitchell Camera of California?

A. Well, sir, I don't think I can answer that question. I was in an engineering capacity, and my partner, Mr. Boeger, was the business man, and he handled all of that.

We discussed what we were going to do, and I knew some of his plans. It was probably in the fall or winter of 1928-1929, some time in there. My partner, H. F. Boeger, wanted to get out of business. He thought we could sell to DuPont. At that time I told him that the people who might be interested in buying the business was the Grandeur Corporation, a company that we had been doing business with. A man by the name of E. I. Sponable had been the man that we had had contact with regarding the Grandeur Camera, and I told my partner he might see Sponable who might be interested in the corporation.

My partner went to New York and contacted Mr.

(Testimony of George A. Mitchell.)

Sponable, and through rumors we got back in various ways we heard that he had been introduced to a man by the name of Harley Clarke. I first learned early in 1929 or late in 1928 that Mr. Harley Clarke was interested in acquiring the corporation. The Grandeur [81] Corporation that I mentioned is the same Grandeur Corporation that acquired the stock of the Mitchell Camera Corporation of Delaware. I didn't know whether Mr. Clarke was acquiring the Mitchell Camera Corporation for himself, or as agent for somebody else. I haven't any idea how much was paid for the assets. I know how much we received, which was \$1,475,000.00.

Q. And that was under the contract which we have stipulated here, June 6, 1929, I believe?

A. I presume so.

Q. I show you what purports to be a contract of June 6, 1929, and ask you if that is the contract under which Mr. Clarke acquired the assets of the Mitchell Camera Corporation of California?

A. Well, as far as I know, yes.

(Thereupon there was offered and received in evidence as Respondent's Exhibit A a photostatic copy of document which the witness identified as agreement placing in escrow the assets of the Mitchell Camera Corporation of California which the witness and his partner, H. F. Boeger, agreed to sell to Harley L. Clarke.)

I testified that the properties and assets of the Mitchell Camera Corporation were sold for \$1,475,000.00. I had nothing to do with arriving at that

(Testimony of George A. Mitchell.)

figure. I gave Mr. Boeger power of attorney, and I didn't instruct him in any way. I was agreeable to anything Mr. Boeger did. I knew he would look after my interest. I owned a one-third interest in the corporation and I accepted that figure.

In connection with the sale of the assets of Mitchell Camera Corporation of California, Mr. Boeger and I agreed that we would not engage in or become interested in any motion picture camera business other than with the buyer or with the Mitchell Camera Corporation of Delaware for a period of five years. That was a customary agreement. In 1929 I became an employee of the Mitchell Camera Corporation of Delaware. I was not an officer in that corporation, nor so far as I know, a director. I don't know who the officers, directors or stockholders were. Mr. Boeger was the business manager.

Q. You do know Mr. Clarke paid \$1,475,000.00 for all of the assets of the Mitchell Camera?

A. I know we received that amount of money.

Q. Answer this yes or no: Do you know as a fact what Mitchell Camera Corporation of Delaware paid to Mr. Clarke? A. No, sir.

Redirect Examination

By Mr. Friedman:

I was employed by the new corporation for a period of about five years at \$25,000 a year. On, I think, the 28th of June, 1929, Mr. Clarke called and said that they had decided to pay all cash for

(Testimony of George A. Mitchell.)

the assets of Mitchell of California, so that the agreement was consummated in cash rather than in stock. We got the money in the Fall of 1929; I think it was about September.

(Witness excused.)

(Thereupon there was offered and received in evidence as Respondent's Exhibit B the minutes of March 16, 1932, Special Meeting of Board of Directors of Mitchell Camera Corporation and the minutes of a Special Meeting of Board of Directors held in New York on August 2, 1929. There was also offered and received in evidence, as Petitioner's Exhibit No. 12, the charter of Mitchell Camera Corporation of Delaware.)

SIDNEY R. REED

called as witness for and on behalf of Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Friedman:

(Thereupon there was offered and received in evidence as Petitioner's Exhibit 13 the income tax return for the year 1931 filed by Grandeur, Inc., which was a consolidated return of Grandeur, Inc., and Petitioner.

(Testimony of Sidney R. Reed.)

(There was also offered and received in evidence [83] as Petitioner's Exhibit 14 a letter dated January 5, 1934, from the Internal Revenue Agent in Charge in New York in reference to his examination of Petitioner's return for the year 1931.)

My home is in Burbank, California. I am auditor, accountant and tax consultant and a member of the accounting firm of Sidney R. Reed & Co. I have been an accountant for the Petitioner since 1941, and first prepared its tax return for that year. In connection with the preparation of that return I examined into the history of the company from its inception. I examined the tax returns for prior years and the Revenue Agent's reports relating thereto. I have seen the minutes of the Special Meeting of the Board of Directors held on July 16, 1929, which Minutes are attached to the stipulation and marked Exhibit 2. I audited the transaction referred to in those minutes because the Examining Agent in reviewing the 1941 return questioned the amortization which the company claimed. In examining into the validity of this proposed assessment, I went back to the inception of the company to establish the proper basis for amortization of patents. I found that the transactions referred to in the minutes were consummated.

(Witness temporarily excused.)

HARLEY L. CLARKE

called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Friedman:

I reside at 2603 Sheridan Road, Evanston, Illinois. I was subpoenaed here as witness for the government in this proceeding. My signature appears on the proposal which is Petitioner's Exhibit 1, attached to the stipulation. The next to the last paragraph of this proposal signed by me and dated July 12, 1929, says "In consideration of the foregoing you shall pay to or upon the order of the undersigned the sum of \$3,100,000.00 in cash." That proposal was accepted by the Petitioner, the Mitchell Camera Corporation of Delaware. A proposal on the [84] part of Grandeur, Inc., to purchase 30,000 shares of Petitioner, Mitchell Camera Corporation of Delaware, for the sum of \$3,100,000 was also accepted and that transaction was carried out.

(Thereupon the witness identified his signature on a photostatic copy of check payable to the Mitchell Camera Corporation under date of August 1, 1929, in the sum of \$3,000,000.00, signed by Grandeur, Inc., Harley L. Clarke, President, and endorsed "for deposit and credit to the account of Mitchell Camera Corporation

(Testimony of Harley L. Clarke.)

in the C.N.B.” This document was offered and received in evidence as Petitioner’s Exhibit 15.)

I received the consideration of \$3,100,000.00 referred to in this proposal.

Mr. Friedman: That is all.

Cross-Examination

By Mr. Woolf:

Q. Mr. Clarke, you said you received \$3,100,000.00. Now let us think back to this transaction. Did you receive this \$3,100,000.00, from Grandeur, Incorporated, or did you receive this \$3,100,000.00 from Mitchell Camera Corporation of Delaware?—the Petitioner here?

A. The \$3,100,000.00 was received by one of the companies. I think if you have the other record, it will show you where it went.

Q. I merely ask you if you remember.

A. No, I do not.

Q. You don’t remember whether you received it from Grandeur? A. No.

Q. Or whether you received it from the Petitioner? A. I do not.

Mr. Woolf: That is all, your Honor.

The Court: You are excused.

(Witness excused.)

The Court: The witness who left the stand temporarily a few minutes ago, will resume the stand.

SIDNEY R. REED

called as witness for and on behalf of petitioner, having been previously duly sworn, resumed the stand and was examined and testified further as follows:

Direct Examination

(Continued)

By Mr. Friedman:

After the agent examined the 1941 return I directed that entries be made on the books of the Petitioner corporation to adjust the patent account, the good will account, and the reserve for amortization.

Q. What entries were made by you, Mr. Reed?

A. The patent account was charged with \$1,625,000.00; the good will, franchise rights and going concern were credited with \$1,625,000.00. The explanation is: "To increase patents cost to actual amount paid for same at inception of company. This amount was erroneously charged to good will, franchise rights and going concern. See Revenue Agent's report dated January 5, 1934, and protest on brief filed with Internal Revenue Bureau dated February 10, 1944." I found that it was necessary to make these entries because, upon investigation to determine whether the agent was right, I determined that the company had acquired no good will at its inception and that the accountants at that time should have charged the patent account for their value, which was the difference between the value of tangible assets and the consideration paid for the entire assets. When I made those entries I

(Testimony of Sidney R. Reed.)

considered the net tangible assets at a figure of \$294,842.41. Now that it has been stipulated that the net tangible assets were in fact \$239,821.05, this change in the figure would make a difference in the entries which I made. It would further increase the patent value by a difference of \$55,021.36. I have prepared a computation showing the depreciation to which the Petitioner should be entitled in the years 1939, 1940, 1941 on the Commissioner's figure of \$1,180,000.00 (odd) and also on the Petitioner's figure of \$2,185,179.59.

Mr. Woolf: I object, your Honor. This merely is the witness' opinion of what should be the value. That is the question we are presenting to the Court. That is for the Court to determine and decide. I object on that ground, your Honor.

The Court: We overrule the objection, note an exception to the Respondent, and receive the exhibit, as merely being an expression of opinion of this witness and which opinion is based upon facts, evidence of which is already in this record. The objection is overruled and exception noted for the Respondent.

(Thereupon the document above referred to was offered and received in evidence and marked Petitioner's Exhibit 16.)

Cross-Examination

By Mr. Woolf:

The method which I used in preparing Exhibit 16 does not reflect the depreciation previously claimed on the returns filed by the Petitioner and allowed by the Commissioner.

(Testimony of Sidney R. Reed.)

Redirect Examination

By Mr. Friedman:

Q. Mr. Reed, will you please explain your last answer?

A. Yes. The books of the company, under the direction of Haskins and Sells, who audited the books, were adjusted to conform to the Commissioner's agreement in 1934 in conjunction with the audit of the 1931 return.

In preparing the return, I claimed amortization in accordance with that theory. The Examining Agent disregarded that theory theretofore followed by the Commissioner.

Q. In what respect?

A. In the respect of the unused amortization, the Commissioner [87] accumulates a greater reserve than should be taken under the theory followed by the Commissioner in 1934.

Q. So that by accumulating more than would be allowable under the 1934 adjustment——

A. Yes.

Q. ——the Commissioner denies depreciation which was actually sustained in 1939, 1940 and 1941, is that correct? A. Yes.

Mr. Woolf: In your opinion is that correct.

The Court: Just a minute. You will have an opportunity to cross-examine.

Q. (By Mr. Friedman): And getting back to the question we had before, if the 1934 settlement had been lived up to by the Commissioner and the

(Testimony of Sidney R. Reed.)

taxpayer, the Petitioner, there would be an allowance for depreciation on patents in the year 1940 in excess of that which has been allowed, and also a further allowance of some \$95,000.00 in the year 1941; is that correct? A. Yes, sir.

Recross-Examination

By Mr. Woolf:

Q. These last questions that Mr. Friedman has just asked you, and your answers, that is based on your opinion as to the computations?

A. As to the computations, yes, but the question of the proper amount of amortization in this matter was opened up by the Commissioner. It is the Commissioner who set aside the theory that he formerly established, back in 1934, and it was not the Petitioner that initiated the investigation of this amortization account.

Q. That is your opinion.

A. That is the fact. You see, I filed a return in accordance with [88] the books. It was the Examining Agent who contended the amortization claimed was too great. And the books reflected the settlement entered into in 1934 between the Petitioner and the Bureau.

Mr. Woolf: That is all, your Honor.

(Witness excused.)

The Court: We will recess until two o'clock.

(Thereupon, at 12:25 p.m., a recess was taken until 2:00 o'clock p.m. of the same day.)

Afternoon Session

The hearing was resumed, pursuant to recess, at 2:00 p.m.

SIDNEY R. REED

recalled as witness for and on behalf of the Petitioner, having previously been duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Friedman:

During the recess I have computed the amount of depreciation allocable to the years 1939, 1940 and 1941 on the average life method, assuming the Commissioner's cost of \$1,180,157.59. Without the \$55,021.36 adjustment, the depreciation would be \$95,430.50 for 1939, \$95,430.50 for 1940, and \$90,659.28 for 1941. With the \$55,021.36 adjustment, the depreciation would be \$99,880.23 for 1939, \$99,880.23 for 1940, and \$94,880.07 for 1941. I am familiar with the method of depreciation applied by this Court in the Simmons case. That method was to determine the number of unexpired months of all patents and to consider as amortization expense in a taxable year the proportion of the basis, in accordance with the number of months expiring in that year, to the total number of months. Applying that method to the figure \$1,235,178.95, which would be the basis used by the Commissioner plus the \$55,000.00 item, the amount of depreciation for 1939 would be \$58,817.28, for 1940, \$56,597.76, and for 1941, \$56,597.76. [89]

(Witness excused.)

Mr. Friedman: That is the Petitioner's case.

HARLEY L. CLARKE

called as a witness for and on behalf of the respondent, having been previously duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Woolf:

My business address is 30 North LaSalle Street, Chicago, Illinois. I am an industrial engineer. In 1929 I was engaged in the utilities business and also owned the controlling interest in several companies such as the International Projector Corporation, Theatre Equipment Company. In 1929, I knew of a corporation known as General Theatres Equipment, Incorporated.

Q. In 1929, did you know of a corporation by the name of International Projector Corporation?

A. Yes.

Q. Did you own any stock in that corporation?

Mr. Friedman: If your Honor please, I object, on the ground that it is immaterial as having no bearing on this problem.

The Court: What is the materiality?

Mr. Woolf: Well, if your Honor please, I am leading up to show that General Theatres Equipment acquired certain corporations, owned and controlled certain corporations. The witness here is president of General Theatres, and he was acting on behalf of General Theatres in acquiring the four lamp companies and the stock of the Mitchell Camera Company. It is all part of one transaction.

(Testimony of Harley L. Clarke.)

The Court: Overrule the objection. Exception noted for the Petitioner. Proceed. [90]

Q. (By Mr. Woolf): In 1929, Mr. Clarke, did you know of a corporation known as General Theatres Equipment, Incorporated?

A. Yes.

Q. When was that corporation organized?

Mr. Friedman: If your Honor please, may my same objections go to these other questions, without repeating them each time?

The Court: Well, in order to do that, it is suggested that the Respondent make an offer as to what he proposes to show by this witness. Then you can make your objection, we will rule on it, and dispose of it once for all.

Mr. Woolf: I propose to show by this witness, if your Honor please, that General Theatres Equipment had \$11,400,000 allocated to Mr. Clarke to acquire certain companies, one of which was the Mitchell Camera Company of California.

I propose to show that General Theatres Equipment, Incorporated, acquired one-half of the stock of the Grandeur Corporation, which owned the stock of the Mitchell Camera Corporation of Delaware, the Petitioner here.

I also intend to show the transactions between Mr. Clarke and Mr. Fox, to show how the five million dollars was expended by Mr. Clarke in acquiring the corporations.

I also intend to show the consideration, how it passed from one corporation to another, and to

(Testimony of Harley L. Clarke.)

prove that the cost of all the properties, assets, patents and patent rights to the Petitioner here was not \$3,100,000.00.

The Witness: I remember appearing before the Committee on Banking and Currency, before the United States Senate, commonly called the Pecora Investigating Committee, on November 14 and November 22, 1933. The testimony I gave at that [91] hearing was under oath. Since that investigation I have not examined the record of the hearing. It was recorded. After reading the official copy of the hearing before the Committee on Banking and Currency, my memory is refreshed, and the answer recorded that the General Theatres Equipment Corporation was organized on July 11, 1929, is correct. The General Theatres Equipment Corporation was organized for the purpose of taking over the properties of the International Projector and other properties that were to be acquired. I owned sufficient stock in the General Theatres Equipment Corporation to give me control of the company. In 1929, I was an officer and controlling stockholder of the International Projector Corporation that was taken over by the General Theatres Equipment Corporation. In the early part of 1929, or the latter part of 1928, I desired to acquire certain companies engaged in manufacturing lamps and equipment for theatres. These were the J. E. McCauley Manufacturing Company, the Strong Electric Company, Ashcraft Automatic Arc Company, and Hall & Connelly, Incorporated. I do not think I had any

(Testimony of Harley L. Clarke.)

conversations with Mr. William Fox in regard to acquiring these four so-called lamp companies, and don't recall that I ever had any correspondence with Mr. Fox in regard to acquiring the Mitchell Camera Company of California.

I remember that letter which you show me, dated May 24, 1929, and reproduced at page 3719 of the reported hearings of the Committee on Banking and Currency. The letter was offered in evidence before that investigation.

(The document above referred to was received in evidence and marked Respondent's Exhibit C.)

The Court: That is a letter from whom to whom?

Mr. Woolf: I offer in evidence a letter addressed to Mr. William Fox, Fox Film Corporation, New York City, signed by Mr. H. L. Clarke.

The Court: That is the witness on the stand?

Mr. Woolf: That is the witness on the stand.

Q. (By Mr. Woolf): Is not that correct, Mr. Clarke? A. Yes.

Mr. Friedman: That letter is not offered as proof of the transactions mentioned in it?

Mr. Woolf: No.

The Witness: I remember on the same day addressing another letter to Mr. William Fox which was offered and received as an exhibit at the Pecora Investigation. I identify the copy which you show me from that record.

(Testimony of Harley L. Clarke.)

(The document above referred to was received in evidence and marked Respondent's Exhibit D.)

When I acquired the Mitchell Camera Company of California, I intended to put it into another company that would own it and some others. We had several names of companies we were organizing. It turned out to be General Theatres.

The Court: May I ask this question at this point: When you bought it, was there any control, oral or written, under which you were obligated, or any obligation was created, compelling you or obligating you to do anything with that?

The Witness: Only, your Honor, what is in writing here.

The Court: And is that in evidence here?

The Witness: This letter is in evidence.

The Court: Very well.

Q. (By Mr. Woolf): I show you on page 3440 of the reported document of hearings, Exhibit 135, which you introduced at the hearing, and I ask you to turn to page 3440 and examine it.

A. (Witness reads.) [93]

The Witness: The total amount received by General Theatres Equipment from certain securities sold on August 1, 1929, to Chase Securities, Pynchon, West, Hammonds, and Halsey and Stewart was \$11,400,000.00. Refreshing my recollection by examining this exhibit, those proceeds were used as follows:

(Testimony of Harley L. Clarke.)

International Projector Corporation, 25000 shares of preferred at 115.....	\$ 2,875,000.00
National Theatres Supply Company, 20000 shares of preferred at 107½.....	2,150,000.00
235,800 Five Year 6½% Sinking Fund Gold Notes at 105.....	247,590.00
Theatre Equipment Acceptance Corporation, 3000 shares \$6.00 dividend preferred stock at 110.....	330,000.00
2,000 shares, \$7.00 Dividend Preferred stock at 195	210,000.00
Grandeur, Incorporated, 50000 shares 50% capital stock.....	2,000,000.00
J. McCauley Manufacturing Company—four companies in brackets—J. McCauley Manufacturing Company, Strong Electric Company, a corporation, Ashcraft Automatic Arc Company, Hall and Connelly, Inc.....	3,000,000.00
Cash for working capital.....	587,410.00
A total of.....	\$ 11,400,000.00

Q. Does not that mean that G.T.E. acquired those assets and that was the amount that they paid for them? A. Yes.

I had general direction of handling those transactions on behalf of G.T.E.

Again examining the exhibit, and refreshing my recollection, we paid \$1,131,422.93 for the J. E. McCauley Manufacturing Company, \$316,000.00 for the Strong Electric Company, \$160,000.00 for the Ashcraft Automatic Arc Company, and \$1,475,000.00 for Mitchell Camera. Now I think in fairness, if I may add something I would like to do it—on this Mitchell Camera Company and the J. E. [94] McCauley Company, very good sized commissions were paid on both of these deals. Some commissions were

(Testimony of Harley L. Clarke.)

paid outside of what appears on the exhibit. I would say on Mitchell Camera, perhaps three hundred and fifty, four hundred thousand dollars; I would say on the J. E. McCauley Manufacturing Company perhaps a couple of hundred thousand.

The General Theatres Equipment, Incorporated, acquired the four lamp companies and the interest in Grandeur for five million three hundred and twenty-two thousand odd dollars.

In 1929, I was President of General Theatres Equipment, Incorporated and of Grandeur, Incorporated. I don't remember whether in 1929 I was President of the Petitioner, or whether it was Mr. Green or Mr. Michael.

I obtained the \$1,475,000.00 which I paid for the assets and properties of the Mitchell Camera Company of California from financing. I can't earmark the dollars.

In 1929 General Theatres Equipment, Inc., acquired one-half the stock of Grandeur, Inc. at a cost of two million dollars, I believe. I made a payment to Mr. William Fox of two million dollars in connection with Grandeur, Inc. in 1929 I think.

Mr. Friedman: I have no objection to your reading the dates and amounts of the checks.

Mr. Woolf: All right. Check, New York, August 1, 1929: "Pay to the Order of William Fox, \$1,625,000.00," signed "H. L. Clarke." "Chase National Bank, New York," Endorsed "For Deposit,"

(Testimony of Harley L. Clarke.)

and check dated New York, August 1, 1929, "Pay to the order of William Fox, \$375,000.00, Chase National Bank, City of New York," signed "H. L. Clarke." [95]

The Witness: There was a written agreement between Mr. Fox and me as to what was to be done with that two million dollars. I don't know what Mr. Fox did with the two million dollars. Either Mr. Fox or somebody else acquired the other 50% of Grandeur, Incorporated. I don't know if he turned it over to anybody else or not.

I remember a contract entered into between Grandeur, Incorporated, and Fox Theatres Corporation in June, 1929. I identify the photostatic copy of the contract which you show me.

(The document above referred to was received in evidence and marked Respondent's Exhibit E.)

Refreshing my recollection from the minute book of the Mitchell Camera Corporation of Delaware which you show me, I was President in 1929.

The two million dollars which I paid to Mr. William Fox in 1929 was my own personal money. I couldn't ear mark the dollars.

I identify a copy of a letter dated May 25, 1929, addressed to Mr. William Fox, and signed by H. L. Clarke, which you show me.

(The document above referred to was received in evidence and marked Respondent's Exhibit F.)

(Testimony of Harley L. Clarke.)

During the period that I owned the Mitchell Camera Company of California and before the time that it was actually turned over to the Petitioner, I would say that the intent was that I owned the Mitchell Camera Company as agent or intermediary for General Theatres Equipment, Incorporated.

The financing by which I acquired Mitchell Camera Company of California was out of the financing of General Theatres Equipment, Inc.

Q. Mr. Clarke, actually, of the four million dollars that was paid into Grandeur, Inc., \$3,100,000.00 came back to you, is that correct?

A. Came back to me?

Q. Yes. A. Personally, you mean?

Q. To you personally. [96]

A. Came back to me probably in the form of stock. I can't answer your question any better than that.

Q. Four million dollars, I believe the record shows, was paid into Grandeur, Inc., for all of its capital stock. Is that correct?

A. I think that is correct. I say I think because I——

Q. Now, for your interest and your ownership of the Mitchell Camera Company of California, you received back \$3,100,000 of that \$4,000,000; is that correct?

A. Well, when you say received back, are you saying that Grandeur paid three million one hundred thousand for Mitchell?

(Testimony of Harley L. Clarke.)

Q. I am saying that you, either personally or on behalf of General Theatres Equipment, Inc., received \$3,100,000 in return for which the Petitioner here received the assets and properties, patents, patent applications—all of the property of the Mitchell Camera Company of California.

A. I think that is correct, but I am not too definite about it.

Q. Well, there is no question about your receiving \$3,100,000, is there?

A. When you say “you,” you mean General Theatres, or H. L. Clarke?

Q. That is what I am trying to bring out.

A. I want to answer your question directly.

The Court: Well, do you mean whether or not the witness did?

Q. (By Mr. Woolf): Did you, acting for yourself or on behalf of General Theatres Equipment, Inc., receive back \$3,100,000 of the \$4,000,000 that was paid into Grandeur for its stock?

A. I think that is correct. I would like to add to it, though, that it would be possible for me to find that out and let you know. I will make the answer that way, with the understanding that if I want to change it, I can. [97]

It is correct that General Theatres Equipment, Inc. acquired one-half of the stock of Grandeur for two million dollars, and that I gave two checks totaling two million dollars to Mr. William Fox. I think it is correct that Mr. Fox paid in two million dollars for a half interest in Grandeur, but I have nothing

(Testimony of Harley L. Clarke.)

in front of me or in my memory to say yes. The \$3,100,000 that I received for the transfer of the assets of the Mitchell Camera Company of California to the Mitchell Camera Corporation of Delaware came out of the financing of General Theatres.

Mr. Fox was given stock of General Theatres Equipment, but whether it was at the time he was given the two checks for two million dollars, I don't know.

(Thereupon there was offered and received in evidence, as Respondent's Exhibit G a copy of Senate Committee Exhibit No. 135, containing figures as to which the witness had previously testified.)

Cross-Examination

By Mr. Friedman:

I acquired certain companies—McCauley Manufacturing, Strong Electric, Ashcraft Automatic Arc, and Hall and Connelly. I think they were acquired in my name. I paid a total of \$1,699,422.93 for these properties, and sold them to someone—General Theatres or someone—for three million dollars. I purchased the assets of the Mitchell Camera Company of California for \$1,475,000.00. In addition to the \$1,475,000, I paid commissions on the Mitchell Camera Corporation acquisition of between \$350,000 and \$400,000. The purpose of acquiring the Mitchell Camera Company of California was particularly to manufacture a larger camera which would use the 70 millimeter instead of the 35 millimeter film. The

(Testimony of Harley L. Clarke.)

Mitchell Camera Company of California had a number of patents which we acquired when we bought the business. The business of the Mitchell Camera Company was the manufacture, under patents, of motion picture cameras. In order to get the [98] right to manufacture the motion picture cameras, I had to have the patents of the corporation. I was particularly seeking, in acquiring the Mitchell Camera Corporation of California, the right to build these 70 millimeter cameras.

I believe it is correct that four million dollars was paid into Grandeur for its stock, two million of which was paid in by General Theatres. Of that four million dollars, Grandeur used \$3,100,000 to acquire the stock of the Mitchell Camera Corporation of Delaware, leaving a balance of \$900,000 in the treasury of Grandeur. The Mitchell Camera Corporation of Delaware then paid \$3,100,000 out of its funds to acquire the assets from me under my offer of July 12, 1929. I do not recall whether or not the payment to me went into my personal bank account.

The monies which I paid to Mr. Fox came out of my personal funds. I had sufficient funds to cover this \$2,000,000 payment without the \$3,100,000 which I received from the Mitchell Camera Corporation.

I do not know whether the deposit of \$3,000,000 on August 2, 1929, which you show me from a transcript of my account in the Chase National Bank came from the Petitioner. I don't know where it

(Testimony of Harley L. Clarke.)

came from. I do not know to whom the payment of \$3,000,000 shown in the account of the Mitchell Camera Corporation of Delaware was paid. I do know that under the agreement of July 12, 1929, I was to receive \$3,100,000 from Mitchell Camera Corporation of Delaware.

Q. Did you sell Grandeur the stock, or did you sell it the assets of the Mitchell Camera Corporation for the \$3,100,000 you got from Mitchell Camera?

A. Yes.

Q. And you got the consideration named there, did you? A. Yes.

Q. Now, you sold the assets not to Grandeur, but to Mitchell Camera of Delaware, is that correct?

A. That is my recollection, yes. [99]

Q. Will you refresh your recollection from those minutes and answer the question yes or no?

A. Yes.

I assume I had a written agreement with General Theatres Equipment relative to these transactions. I do not have it with me. I remember Murrey W. Dodge of the Chase Bank. I do not recall that he testified before the Senate Committee that I was acquiring these properties on my own behalf.

Q. I ask you whether you turned over the profit which you made in these transactions to the General Theatres Equipment, Incorporated?

A. Yes, I made no profit out of any transaction of the General Theatres Company.

Q. Let us canvass that a minute.

A. O.K. I would like to have you. Internal Revenue has done a good job of it.

(Testimony of Harley L. Clarke.)

The Witness: I received, in these two transactions, \$6,100,000.00. Of that money, I paid out \$1,699,000 for the lamp companies. I paid out \$1,475,000 plus \$350,000 or \$400,000 for Mitchell. If your arithmetic is correct, that would be a total of \$3,565,000. And for those assets I received \$6,100,000. I do not have any check with me showing the payment of the balance of that money to General Theatres Equipment, nor do I recollect how the transactions were handled. If you are interested, it will be possible to find out. I think that the difference between the \$3,000,000 I got for the sale of the lamp companies and the \$1,699,000 I paid for the lamp companies all checked out; I have no record of giving an accounting to the General Theatres Equipment Company for this difference. When I first started to purchase this property, General Theatres Equipment Company was not even organized. After I contracted to purchase these properties, I think I could have transferred them to any place I wanted to. So I could not have been acting specifically as agent for General [100] Theatres Equipment Company at that time.

The money which was used in this financing was public money from stock sold to the public—\$11,400,000. I bought some of the stock myself. Again reading Respondent's Exhibit C, I don't recall whether another contract superseded this, and some other deal made. I don't recall whether I paid the \$250,000 referred to in the third paragraph of

(Testimony of Harley L. Clarke.)

that letter. This letter says I agreed to do it, so I assume I did it. If any changes were made, I don't recall them.

(Witness excused.)

(Thereupon, at 4:30 o'clock p.m. an adjournment was taken until the following day, Wednesday, October 23, 1946, at 9:30 o'clock a.m.)

(The Court met pursuant to adjournment.)

WILLIAM FOX

called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination

By Mr. Woolf:

My address is 272 Park Avenue, New York City. I am the General Manager of the Mitchell Camera Corporation. In 1929 I was engaged in the motion picture business. I was also president of the Fox Film Corporation and the Fox Theatres Corporation from the time of their inception in 1915 and 1925, respectively. I recall the organization of Grandeur, Incorporated, which I believe is still in existence. At the present time the stock of that corporation is owned by the All Continent Corporation, a holding corporation. The stock of the All Continent Corporation is owned by Mrs. Eva Fox,

(Testimony of William Fox.)

my wife. Belle Fox and Mona Fox are my daughters. Grandeur, Inc. was organized during the year 1929. [101] Upon organization of Grandeur, Incorporated, I acquired one-half of the stock and the Harley L. Clarke interests acquired the other half. I was confined to the hospital at the time when Mr. Clarke testified he gave me two checks in the total amount of two million dollars. I later learned that he had given us two checks, and that we had given the Harley Clarke interests some checks in return. I caused to be paid into Grandeur, Incorporated a check for \$1,950,000.00 for my one-half interest in Grandeur stock. It was in exchange for the checks that Clarke gave me.

Mr. Friedman: I concede that a check was issued by Mr. Fox and signed by someone authorized payable to Grandeur, Incorporated for \$1,950,000 on August 1, or thereabouts, for stock in Grandeur, Incorporated. Here it is.

(The document above referred to, having been first identified by the witness, was offered and received in evidence and marked Respondent's Exhibit H.)

The Witness: I paid nothing for the stock of Grandeur Incorporated. I got that as part of a transaction between Harley Clarke and myself. It seems that I had gotten two million dollars of checks, and gave Grandeur Incorporated two million dollars of checks. I think some time in the month of May, Mr. Clarke asked me for a check of

(Testimony of William Fox.)

\$50,000. But all those transactions that Clarke had had, and various letters he had written me during the month of May and the early part of June, all of them were dissolved, and none of them carried out, and a new transaction was entered into the latter part of June or early part of July 1929. In accordance with my understanding with Mr. Clarke, I was not to pay any money for my half interest in Grandeur, Incorporated. I was to give him something else in return for it. In 1929 I also received from Mr. Clarke 25,000 shares of stock of General Theatres Equipment.

Q. (By Mr. Woolf): Mr. Fox, I hand you a document, and ask you if that is your signature?

A. Yes, sir.

Mr. Woolf: Your Honor, I offer in evidence the Closing Agreement for the years 1930 and 1931, which was signed by Mr. Fox, the witness on the stand, for the purpose of showing the basis that was arrived at for depreciation in regard to those two years, and which was followed by the Bureau and the taxpayer from then on.

Mr. Friedman: If your Honor please, I have no objection to it, except that it is not a Closing Agreement. It is what is known as "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax," Form 870. With that correction, I have no objection to the offer, to show the prior history of the case.

The Court: Do you accept the correction?

(Testimony of William Fox.)

Mr. Woolf: I accept the correction, your Honor. It speaks for itself.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit I.)

Mr. Woolf: I offer in evidence copy of the Commissioner's acceptance of the Waiver, which was mailed to Grandeur, Incorporated.

Mr. Friedman: No objection.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit J.)

Mr. Woolf: That is all from this witness, your Honor.

Cross-Examination

By Mr. Friedman:

Q. Mr. Fox, will you please state what the transaction was that you finally carried out between you and Mr. Clarke relating to the matter we are now discussing—Mitchell Camera Corporation of Delaware? [103]

Mr. Woolf: Is that proper cross-examination, or are you making him your witness?

Mr. Friedman: I am examining him on the questions you asked relating to his transactions with Mr. Clarke. You asked him some questions relating to that. He said the agreements were not

(Testimony of William Fox.)

carried out, and I am cross-examining him on that.

The Court: May we ask you a question? What is your interest in the Petitioner company?

The Witness: Well, my family owns the Petitioner company.

The Court: Is this witness's testimony inconsistent with that of the witness Clarke?

Mr. Friedman: Yes, your Honor, to this extent; in his explanation he stated that the agreements that have been introduced, agreements in writing, were not carried out.

(At this point in the testimony the Court granted an earlier motion made by Respondent that the witness be treated as an adverse witness to Respondent.)

The Witness: I had over a long period of time developed a new camera called the Grandeur camera and I presume that I had expended three or four hundred thousand dollars on it and it was probably the most revolutionary thing in the business with the exception of sound-on-film. Grandeur was the name we gave to the camera on account of its width. It was a 70 millimeter camera, twice the width of the present film now being used. Mr. Clarke had communicated with me about this development and we entered into negotiations. The result of the negotiations had with Mr. Clarke were as follows: He was to create a company called Grandeur, Incorporated. I was to receive one-half of the stock. When the transaction was completed, Grandeur, In-

(Testimony of William Fox.)

corporated was to have as its assets the Mitchell Camera Company of Delaware, and all of the experimental work that I had [104] done on Grandeur, and in addition to the half interest that I was to have in Grandeur, Inc., he was to give me 25,000 shares of General Equipment stock.

The Court: Is that General Theatres?

The Witness: General Theatres Equipment stock. That was how the transaction was concluded between Mr. Clarke and myself. Now the inner workings of the deal he worked out, and how he did it, I don't know a thing about that. It was concluded by Clarke at the time that the Mitchell Camera Corporation and the Grandeur Company would form a most wonderful combine, and the patents of the Mitchell Camera Corporation with the patents of Grandeur were required to complete the transaction and control the wide film situation.

At that time the Mitchell Camera Company of California had built a Grandeur camera for us, partly under their patents and partly under ours. The purpose of Mr. Clarke and myself in acquiring Mitchell of California was to secure its patents. That is to say its machinery and its building meant nothing to us. It controlled the patents of the 35 Millimeter film. The value of Mitchell had to Grandeur, was the value of its patents. My interest in Mitchell was based entirely upon the patents which it owned, not upon its good will, or its machinery or buildings.

(Testimony of William Fox.)

Cross-Examination

(See ruling)

By Mr. Woolf:

The patents of the Grandeur camera were assigned to me by the inventor, I think some time in 1927 or 1928. Whatever I had in connection with Grandeur was transferred to Grendeur, Incorporated. I presume I transferred patents to Grandeur, Incorporated. They were either patents or patents pending or inventions. Whatever we had that caused us to spend between four and five hundred thousand dollars developing the wide camera, was transferred to Grandeur, Inc. I don't know whether those patents were on the balance sheet of Grandeur, Inc. [105]

Q. Were any of those patents of Grandeur transferred to the Mitchell Camera Corporation, the Petitioner here? A. I don't know, sir.

Q. Were any of them in this list?

The Court: The witness is now being shown what?

Mr. Woolf: He is being shown Petitioner's Exhibit 8 attached to the stipulation of facts.

The Witness: My understanding is that this list contains patents created by the Mitchell Camera Corporation itself.

Q. (By Mr. Woolf): And no Grandeur patents there, is that your answer?

A. Well, this is a list of the Mitchell Camera Corporation patents.

Mr. Woolf: That is all, if your Honor please.

(Witness excused.)

(Thereupon there were offered and received in evidence the tax returns filed by Grandeur, Inc., for the years 1929, 1930, 1932 and 1933, together with the respective audit reports and marked Respondent's Exhibits K, L, M, and N, respectively. There were also offered and received in evidence the tax returns filed by the Mitchell Camera Corporation for the years 1934, 1935, 1936, 1937, 1938, 1939, 1940, and 1941, and marked Respondent's Exhibits O, P, Q, R, S, T, U, and V respectively.)

The Court: Have you a question, Mr. Woolf?

Mr. Woolf: If your Honor please, yesterday there was a witness from the Chase National Bank of New York, who had the transcript of the accounts of Mr. Clarke and Mitchell Camera. Mr. Friedman asked me if I had any objection to his being excused, that he had left photostatic copies of the accounts with him, and I could examine the originals. I stated that there was no objection. I now ask that those be produced in order that they may be offered in evidence.

Mr. Friedman: Well, I have the photostats, but what is the purpose of the offer? That does not make them admissible. [106]

Mr. Woolf: I offer them for the purpose of showing the \$3,000,000 check on August 2, 1929 of the Mitchell Camera Corporation, for the purpose——

Mr. Friedman: Of showing that they received it and paid it, or what?

Mr. Woolf: For the purpose of showing the check dated August 2, 1929 for \$3,000,000, of the Mitchell Camera Corporation.

Mr. Friedman: Well, that check was the check of Grandeur. Do you want to introduce it to show that the Grandeur check was deposited in the account of the Mitchell Camera Corporation, and that Mitchell Camera disbursed \$3,000,000, which appears in the account of Harley L. Clarke on the same date?

Mr. Woolf: Yes.

Mr. Friedman: No objection, for that purpose.

The Court: Received.

(The document above referred to was received in evidence and marked Respondent's Exhibit W.)

The Court: Is there anything further for the Respondent?

Mr. Woolf: No, your Honor.

Mr. Friedman: If your Honor please, may I make one motion? I should like to move to conform the record to the proof with respect to the item of \$55,000 we have referred to in the testimony, and also with respect to the additional cost paid by H. L. Clarke of \$350,000 in connection with the acquisition of Mitchell Camera Corporation of California.

Mr. Woolf: I object, your Honor, as not timely made. He does not have it in writing ready to submit this morning.

The Court: Is that all?

Mr. Woolf: That is all.

The Court: Motion granted. We would like for you to put it in writing as of now, and file the amendment to conform the pleadings to the proof. We think the Petitioner has the right to amend its pleadings in the [107] way it indicates.

Mr. Woolf: The respondent will have the right to file an answer?

The Court: We understand, of course, that you will file a general denial. Is that so?

Mr. Woolf: That is correct.

The Court: That will also be put in writing, as of today.

(Whereupon, at 10:30 o'clock a.m., the hearing in the above-entitled matter was concluded.)

The foregoing is the substance of all the material evidence adduced at the hearing in this cause, and the Petitioner tenders and presents the foregoing as a statement of the evidence in the cause and prays that the same be approved by the Tax Court of the United States and made a part of the record in this cause.

/s/ HARRY FRIEDMAN,
Attorney for the Petitioner,

The above and foregoing statement of evidence contains the substance of all the evidence material for a review of the rulings and decisions assigned as error herein and the same be approved by the Tax Court without notice.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel, Bureau of
Internal Revenue.

Filed T.C.U.S. Jan. 2, 1948. [108]

[Title of Circuit Court of Appeals and Cause.]

MOTION

Whereas the Petitioner above-named has heretofore filed a Petition for Review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision entered herein by the Tax Court of the United States, and

Whereas the Petitioner intends to include as part of the record on review of this case:

1. The stipulation of facts filed on October 22, 1946, with Petitioner's Exhibits 1 to 10, inclusive, attached thereto,

2. Petitioner's Exhibits 11 to 18, inclusive, filed at the hearing, and

3. Respondent's Exhibits A to W, inclusive, filed at the hearing.

Now, Therefore comes the Petitioner, by its attorneys, and moves that the Court enter an order providing that the above-described exhibits be omitted from the printed record on review, and in lieu thereof the Clerk of the Tax Court be directed to transmit to this Court the said exhibits in original form, [109] for the reason that there are many Exhibits, some of which are already in printed form, and the other Exhibits are voluminous and the cost of printing them would be excessive; provided however, that the above described Exhibits remain in the custody of the Clerk of the Tax Court of the United States until ten days before this cause

on review is set for argument in this Court, and then, upon direction of counsel for Petitioner on Review, be transmitted to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit; and, that the Clerk of this Court transmit to the Clerk of the Tax Court of the United States a certified copy of the order entered herein.

Dated: December 17th, 1947.

/s/ HARRY FRIEDMAN,

/s/ BIRGER TINGLOFF,

Attorneys for Petitioner
on Review.

No Objection:

/s/ CHARLES OLIPHANT,

Chief Counsel, Bureau of Internal Revenue, Counsel
for Respondent on Review.

So Ordered:

FRANCIS A. GARRECHT,

Senior United States

Circuit Judge.

A True Copy.

[Endorsed]: Filed Dec. 23, 1947,

PAUL P. O'BRIEN,

Clerk.

Filed T.C.U.S. Dec. 29, 1947.

Received Jan. 6, 1948. [110]

[Title of Circuit Court of Appeals and Cause.]

DESIGNATION OF PORTIONS OF RECORD,
PROCEEDINGS AND EVIDENCE TO BE
TRANSMITTED TO THE CIRCUIT COURT
OF APPEALS

To the Clerk of the Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, copies duly certified as correct of the following documents and records in the above-entitled proceeding in connection with the Petition for Review by the Circuit Court of Appeals for the Ninth Circuit, heretofore filed by the Mitchell Camera Corporation:

1. Docket entries of all proceedings before the Tax Court.

2. Pleadings before the Tax Court:

(a) Amended Petition filed November 4, 1946, including annexed copy of deficiency letter.

(b) Answer to amended Petition.

3. Stipulation of Facts.

3a. Exhibits in original form pursuant to Court Order of December 23, 1947.

4. Findings of Fact, Opinion and Decision.

5. Motion to vacate and set aside the Memorandum Findings of Fact and Opinion, filed July 24, 1947, and notation of denial of motion on July 25, 1947.

6. Petition for Review, together with proof of service of notice of filing, and of service of a copy, of Petition for Review.

7. Statement of Points to be relied upon by the Petitioner.

8. Statement of Evidence as settled and allowed.

9. Court order extending time for the preparation, transmission and delivery of the typewritten transcript of the record on review.

10. Court order for the transmission of exhibits in original form and omission of exhibits from printed record on review.

11. This designation of portions of the record, proceedings and evidence to be contained in the printed record on review.

Said transcript to be prepared, certified and transmitted, as required by law and the rules of the United States Circuit Court of Appeals for the Ninth Circuit.

/s/ HARRY FRIEDMAN,
Attorney for Petitioner
on Review.

Service of a copy of the within designation is hereby admitted this 2nd day of Jan., 1948.

/s/ CHARLES OLIPHANT, CAR
Chief Counsel, Bureau of Internal Revenue, Coun-
sel for Respondent on Review.

Filed T.C.U.S. Jan. 2, 1948. [112]

The Tax Court of the United States
Washington

Docket No. 8058

MITCHELL CAMERA CORPORATION,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

CERTIFICATE

I, Victor S. Mersch, clerk of the Tax Court of the United States do hereby certify that the foregoing pages, 1 to 112, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeipie in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the Tax Court of the United States, at Washington, in the District of Columbia, this 7th day of January, 1948.

[Seal] /s/ VICTOR S. MERSCH, EMT
Clerk, The Tax Court of
the United States.

[Endorsed]: No. 11829. United States Circuit Court of Appeals for the Ninth Circuit. Mitchell Camera Corporation, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record Upon Petition to Review a Decision of the Tax Court of the United States.

Filed January 12, 1948.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals
for the Ninth Circuit.

United States Circuit Court of Appeals
for the Ninth Circuit

T. C. Docket No. 8058

MITCHELL CAMERA CORPORATION,
Petitioner on Review.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent on Review.

**MOTION FOR EXTENSION OF TIME FOR
TRANSMITTING RECORD ON REVIEW**

Whereas, the petitioner on review on November 3, 1947, filed its petition for review from a decision of The Tax Court of the United States and notice thereof and the time for transmitting the record on review will expire, under Rule 30, on December 13, 1947, and

Whereas, counsel for petitioner have submitted a narrative statement of evidence to counsel for

respondent and said statement has not been settled, and therefore the record on review cannot be completed and transmitted to this Honorable Court within the time allowed because of conditions beyond the control of counsel, and additional time is required to complete file and transmit the record to this Honorable Court.

Now, Therefore, the petitioner for review by its counsel, Harry Friedman and Birger Tinglof, respectfully moves that the time within which to complete and transmit the record on review in this proceeding be extended to and including January 20, 1948.

/s/ HARRY FRIEDMAN,
/s/ BIRGER TINGLOF,
Counsel for Petitioner
on Review.

No Objection:

/s/ CHARLES OLIPHANT,
Counsel for Respondent
on Review.

So Ordered:

FRANCIS A. GARRECHT,
Senior United States
Circuit Judge.

A True Copy: Attest: /s/ Paul P. O'Brien,
Clerk.

[Endorsed]: Filed December 8, 1947. Paul P.
O'Brien, Clerk.

Filed T.C.U.S. December 12, 1947.

[Title of Circuit Court of Appeals and Cause.]

PETITIONER'S DESIGNATION OF THE
PARTS OF THE RECORD TO BE PRINTED

To the Clerk of the United States Circuit Court of
Appeals for the Ninth Circuit:

The Mitchell Camera Corporation, the Petitioner on Review herein, by its attorney, Harry Friedman, pursuant to its Petition for Review of the decision of the Tax Court of the United States entered September 9, 1947, designates the parts of the record considered material to the questions on review to be included in the printed transcript of the record, as follows:

1. Docket entries of all proceedings before the Tax Court.
2. Pleadings before the Tax Court:
 - (a) Amended Petition filed November 4, 1946, including annexed copy of deficiency letter.
 - (b) Answer to amended Petition.
3. Stipulation of Facts.
4. Findings of Fact, Opinion and Decision.
5. Motion to vacate and set aside the Memorandum Findings of Fact and Opinion, filed July 24, 1947, and notation of denial of motion on July 25, 1947.

6. Petition for Review, together with proof of service of notice of filing, and of service of a copy of Petition for Review.

7. Statement of Points to be relied upon by the Petitioner.

8. Statement of Evidence as settled and allowed.

9. Court order extending time for the preparation, transmission and delivery of the typewritten transcript of the record on review.

10. Court order for the transmission of exhibits in original form and omission of exhibits from printed record on review.

11. Designation of portions of record, proceedings and evidence to be transmitted to the Circuit Court of Appeals.

12. This designation of the parts of the record to be printed.

/s/ HARRY FRIEDMAN

/s/ BERGER TINGLOF

Attorneys for Petitioner on
Review.

Service of a copy of the designation of the parts of the record to be printed is hereby admitted this 15th day of January, 1948. Agreed to:

/s/ THERON LAMAR CAUDLE,

Assistant Attorney General.

[Endorsed]: Filed Jan. 20, 1948.

No. 11,829

PETITIONER'S OPENING BRIEF

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

MITCHELL CAMERA CORPORATION,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

**Upon Petition to Review a Decision of the Tax Court
of the United States**

Of Counsel:

**SYDNEY R. RUBIN,
Washington, D. C.**

HARRY FRIEDMAN,

**540 Munsey Building,
Washington, D. C.**

BIRGER TINGLOF,

**608 South Hill Street
Los Angeles 14, California**

Attorneys for Petitioner.

Date: March 5, 1948

MAR 12 1948

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United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

No. 11829

MITCHELL CAMERA CORPORATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITIONER'S OPENING BRIEF

JURISDICTIONAL STATEMENT

Mitchell Camera Corporation, petitioner, seeks the re-determination of a deficiency in federal income taxes determined by respondent to be payable for the taxable year ended December 31, 1941. It filed its returns for the years involved with the Collector for the Sixth District of California. Jurisdiction of the proceedings was conferred upon the Tax Court of the United States by section 1100 et seq. of the Internal Revenue Code (26 U. S. C. A.

section 110, et seq.). The provisions of section 1141 of the Internal Revenue Code (26 U. S. C. A. section 1141) give jurisdiction to this Court. The pleadings necessary to show the existence of jurisdiction are the Amended Petition for redetermination of deficiency (R. 5) and the answer thereto (R. 20). From the decision of the Tax Court (R. 68) determining a deficiency in income tax of \$47,720.78 for the year 1941, petitioner has filed its Petition for Review by this Court (R. 71).

STATEMENT OF THE CASE AND QUESTIONS INVOLVED

The principal issues in this case concern the basis to petitioner of a group of patents which it purchased in 1929 and the correct formula for depreciating such basis over the life of the patents. The facts are set out in detail in the opinion of the Tax Court (R. 26) but may be summarized as follows:

The Mitchell Camera Company of California (hereinafter referred to as Mitchell of California) (not the petitioner) for a number of years prior to 1929 was engaged in the business of manufacturing professional motion picture cameras and accessories for the large motion picture studios in California. All of its business was in patented products manufactured under patents which it owned. In 1929 the introduction of "sound" motion picture revolutionized the motion picture industry and Mitchell of California became the sole supplier of cameras for the major motion picture studios. This was because it produced a relatively noiseless camera as compared with that of competitors. Because of the patented features of the Mitchell camera it was practically impossible to use any other camera in the production of "sound" motion pictures (R. 28).

In the early part of 1929, Harley L. Clarke became interested in acquiring the business and assets of Mitchell of California (R. 28, 29). He communicated with William Fox, who also agreed to take an interest in this acquisition (R. 30, 31). On June 6, 1929, Clarke contracted to purchase all the assets of Mitchell of California for \$1,475,000.00.

In 1929, Clarke owned "just over control" in General Theatres Equipment, Inc. It received \$11,400,000 from the sale of its securities (R. 45). Of this fund \$2,000,00 was used to acquire half of the capital stock of Grandeur, Inc. (R. 45, 34). (An additional \$3,000,000 was paid to Clarke to acquire four lamp companies in a transaction not directly here involved) (R. 48). William Fox acquired the other half of Grandeur's stock for \$2,000,000 (R. 34, 45). Clarke was president of Grandeur and of General Theatres Equipment Inc. (R. 56).

Petitioner was incorporated in the State of Delaware on July 12, 1929 (R. 38). Clarke became its president (R. 56). Its charter provided that a director's transactions with the corporation should not be voidable in the absence of fraud or non-disclosure, and that he need not account for the profit on any such transaction (R. 38, 39).

On July 12, 1929, Clarke proposed to sell to petitioner for \$3,100,000.00 in cash all of the assets of Mitchell of California (R. 40; Ex. 1). Petitioner accepted this offer at a meeting of its board of directors on July 16, 1929 (R. 41; Ex. 2). At the same meeting, Clarke presented to petitioner a proposal by Grandeur, Inc., to purchase all of petitioner's capital stock for \$3,100,000 (R. 41), and petitioner accepted this proposal (R. 42).

The above agreements were duly carried out. Clarke caused Mitchell of California and its stockholders to transfer to petitioner, or to an escrow agent, the assets which

Clarke had previously contracted to purchase (R. 22, 42, 44). Clarke paid Mitchell of California's stockholders \$1,475,000 for the assets in accordance with his agreement (R. 44). He testified that he also paid between \$350,000 and \$400,000 in commissions on the purchase (R. 117, 118, 122). Grandeur deposited to petitioner's account its check in payment for petitioner's stock (R. 46). Petitioner issued its check to Clarke for \$3,000,000 (\$100,000 having been previously paid) for the Mitchell of California assets in accordance with its agreement (R. 47).

In settlement of an income tax controversy for the years 1930 and 1931 respondent, in a computation dated January 5, 1934, fixed, as petitioner's basis for the Mitchell of California assets, the price which Clarke had paid for those assets, and computed depreciation accordingly (R. 50, 51). Petitioner executed a waiver, Treasury Form 870, agreeing to revised deficiencies on this basis for those years (R. 51, 52).

For the taxable years 1939, 1940 and 1941, respondent proposed to revise the patent depreciation which petitioner had reported on its returns (R. 54). His theory, as in his 1934 computation, was to fix petitioner's cost of the patents at what he determined to be Clarke's cost, and to depreciate or spread this cost over the average life (12.3666 years) of the group of patents from the date of their acquisition (R. 23, 24, 54, 55). The petitioner seeks to have the cost spread over the full life of the patents. This, together with minor issues not involved in this appeal, resulted in a notice of deficiency in income and declared value excess profits taxes for 1941 in the amounts of \$71,301.66 and \$2,177.28 respectively (R. 26). The years 1939 and 1940 are also involved because of carry over net losses for those years (R. 26).

Petitioner duly filed its petition with the Tax Court of the United States, and, after hearing, the Tax Court

entered its findings of fact and opinion sustaining the respondent on the depreciation issues (R. 26, 57). Petitioner then filed, but the Tax Court denied, a motion requesting the Tax Court to vacate its findings of fact and opinion on the ground that it had failed to observe the procedures prescribed by the Administrative Procedure Act (60 Stat. 237, 5 U. S. C. §1001) (R. 69).

Following the entry of the above opinion, respondent filed a computation, in which petitioner acquiesced subject to right of appeal, reducing the asserted income tax deficiency of petitioner for the year 1941 to \$47,720.78 and eliminating the deficiency in declared value excess profits tax. The Tax Court on September 9, 1947, entered its final decision determining a deficiency in accordance with this computation (R. 68). From this decision, petitioner filed its petition for review by this Court (R. 71).

The questions involved on this review are: (1) Method for determining the basis for depreciation of patents which petitioner acquired when it purchased from Harley L. Clarke all the assets of Mitchell of California; (2) whether the Tax Court could properly exclude from Clarke's cost of the assets commissions which he testified he paid to acquire them; (3) whether the depreciation on a group of patents having varying lives should be spread over the average life, or over the full life of all the patents under a proper formula; (4) whether the basis of patents for the years involved may be adjusted to reflect the correct cumulative depreciation for prior years to the extent that excessive depreciation charges erroneously taken did not result in tax benefit; (5) whether the Tax Court is an agency subject to the Administrative Procedure Act, and if so, what effect this has on its procedures and the scope of review of its decisions.

SPECIFICATION OF ERRORS RELIED ON

1. The Tax Court erred in not holding and deciding that the correct basis for depreciation of the patents which petitioner acquired when it purchased the assets of Mitchell of California was \$3,100,000.00, less the agreed value of the tangible assets.

2. The Tax Court erred in holding and deciding that the basis for depreciation of patents which petitioner purchased from Harley L. Clarke is to be determined by reference to the price which Clarke paid to Mitchell of California for its assets.

3. The Tax Court erred in holding and deciding that the assets of Mitchell of California acquired by petitioner included substantial value in goodwill and intangibles other than patents, and that any part of the purchase price was paid for such goodwill and intangibles.

4. The Tax Court erred in holding and deciding that a figure other than the stipulated value of the net tangible assets might be deducted from the total cost of the assets formerly owned by Mitchell of California in arriving at the cost basis to petitioner of the patents included in such assets.

5. The Tax Court erred in not holding and deciding that the \$350,000.00 to \$400,000.00 which the Government witness, Harley L. Clarke, testified without contradiction that he paid as commissions to acquire the assets of Mitchell of California must be added to Clarke's cost of the assets if such cost is to be treated as the cost of assets to petitioner.

6. The Tax Court erred in holding and deciding that the Commissioner might properly compute depreciation on the group of patents acquired by petitioner on the basis of the average life of the patents, rather than by

spreading depreciation over the entire life of all the patents.

7. The Tax Court erred in not holding and deciding that, where petitioner through error took depreciation for the years 1932 through 1938 in excess of the correct amount, but except for the year 1936 received no tax benefit as a result, the basis for computing depreciation for the years in controversy should be adjusted to reflect the correct amount of depreciation for earlier years.

8. The Tax Court erred in entering its final order and decision that there is a deficiency in petitioner's income tax for the year 1941 of \$47,720.78.

9. The Tax Court erred in denying petitioner's motion to set aside its memorandum findings of fact and opinion for the reason that the Tax Court is an agency of the United States within the meaning of the Administrative Procedure Act (Chapter 324, 60 Stat. 237, 5 U. S. C. §1001), and petitioner was given no opportunity as required by that Act to submit objections or to file exceptions to said opinion or "initial decision" prior to its issuance, or to obtain review by the Tax Court of the report of the Judge who heard the case.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code (1939).

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

"* * * *

"(1) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *"

“(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.”

“SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

“(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.”

“SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

“(a) *Basis (unadjusted) of property.*—The basis of property shall be the cost of such property; except that—* * *

“(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.”

“(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—* * *

“(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *.”

“SEC. 1100. STATUS.

“The Board of Tax Appeals (hereinafter referred to as the ‘Board’) shall be continued as an independent agency in the Executive Branch of the Government. The Board shall be known as the Tax Court of the United States and the members thereof shall be known as the presiding judge and the judges of The Tax Court of the United States.”

“SEC. 1116. HEARINGS.

“Notice and opportunity to be heard upon any proceeding instituted before the Board shall be given

to the taxpayer and the Commissioner. * * * Hearings before the Board and its divisions shall be open to the public, and the testimony, and, if the Board so requires, the argument shall be stenographically reported. * * *,”

Administrative Procedure Act, 60 Stat. 237, 5 U. S. C. §1001).

“SEC. 2. As used in this Act—

“(a) AGENCY.—Agency means each authority (whether or not within or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia. * * *,”

“SEC. 5. In every case of adjudication required by statute to be determined on the record after opportunity for agency hearing * * *

“(b) PROCEDURE.—The agency shall afford all interested parties opportunity for * * * hearing, and decision upon notice and in conformity with sections 7 and 8.”

“SEC 7. In hearings which section * * * 5 requires to be conducted pursuant to this section—

“(a) PRESIDING OFFICERS.—There shall preside at the taking of evidence (1) the agency, (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act; * * *.”

“SEC 8. In cases in which a hearing is required to be conducted in conformity with section 7—

“(a) ACTION BY SUBORDINATES.—In cases in which the agency has not presided at the reception of the evidence, the officer who presided * * * shall initially decide the case or the agency shall require * * * the entire record to be certified to it for initial decision. Whenever such officers make the initial decision and in the absence of either an appeal to the agency or review upon motion of the agency within time provided by rule, such decision shall without further

proceedings then become the decision of the agency. * * * Whenever the agency makes the initial decision without having presided at the reception of the evidence, such officers shall first recommend a decision * * *."

"(b) SUBMITTALS AND DECISIONS.—Prior to each recommended, initial, or tentative decision, or decision upon agency review of the decision of subordinate officers the parties shall be afforded a reasonable opportunity to submit for the consideration of the officers participating in such decisions (1) proposed findings and conclusions, or (2) exceptions to the decisions or recommended decisions of subordinate officers or to tentative agency decisions, and (3) supporting reasons for such exceptions or proposed findings or conclusions. The record shall show the ruling upon each such finding, conclusion, or exception presented. All decisions (including initial, recommended, or tentative decisions) shall become a part of the record and include a statement of (1) findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record; and (2) the appropriate rule, order, sanction, relief, or denial thereof."

"SEC. 10. Except so far as (1) statutes preclude judicial review or (2) agency action is by law committed to agency discretion—

* * * *

(e) SCOPE OF REVIEW.—So far as necessary to decision and where presented the reviewing court shall decide all relevant questions of law, interpret constitutional and statutory provisions, and determine the meaning or applicability of the terms of any agency action. It shall * * * (B) hold unlawful and set aside agency action, findings, and conclusions found to be (1) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law; * * * (4) without observance of procedure required by law; (5) unsupported by substantial evidence in any case subject to the requirements of sections 7 and 8 or otherwise reviewed on the record of an agency hearing provided

by statute; * * * In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party * * *.”

Commissioner's Regulations 103.

“SEC. 19.23 (1)-1. *Depreciation.* * * *

“The proper allowance for such depreciation of any property used in the trade or business is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will at the end of the useful life of the property in the business, equal the cost or other basis of the property determined in accordance with section 113. * * *.”

“SEC. 19.23 (1)-7. *Depreciation of patent or copyright.*—“* * * The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. * * *.”

SUMMARY OF ARGUMENT

1. The petitioner's basis for its patents acquired in 1929 is its cost. All of the evidence shows that petitioner's cost of the assets of Mitchell of California was \$3,100,000, the price which it paid Harley L. Clarke for those assets. It is irrelevant to a determination of petitioner's cost, and therefore basis, that Clarke paid a lesser sum for the assets in a prior transaction; nor may Clarke's profit be excluded in determining petitioner's cost simply because Clarke was an officer of, and had an interest in, petitioner.

2. Petitioner's cost or basis for the patents was \$2,860,-178.95, the difference between its cost of all the assets and the stipulated value of the tangible assets. No part of the price which petitioner paid to Clarke for the assets is attributable to good will because all of Mitchell of Cali-

fornia's value, apart from tangibles, was in patents. As the Tax Court found, Mitchell's monopoly position in the camera industry and its large backlog of orders in 1929 were due to the patented features of the Mitchell camera (R. 28). Moreover, the parties testified without contradiction that the entire consideration for the assets, above the cost of the tangibles, was paid for patents—not for good will or anything else.

3. The Tax Court erred in sustaining a deduction of \$294,842.41 from total cost in arriving at the cost of the patents, when a value of \$239,821.05 for the tangible assets was stipulated. The difference of \$55,021.36 is not, as the Tax Court says, attributable to intangibles other than good will for no such intangibles existed. Instead this difference has its origin in an error which respondent's agent made in a 1934 computation (R. 51) in the exact amount of \$55,021.36.

4. If petitioner's basis is to be measured by Clarke's cost, \$350,000 which Clarke paid in commissions to acquire the Mitchell assets must be included as part of his cost of those assets. The evidence that Clarke paid these commissions to secure the Mitchell assets was clear, uncontroverted, and came from respondent's own witness. The Tax Court erred in holding that more evidence was required to sustain the commission payment, but even if this were true it should have afforded the parties an opportunity to adduce such evidence.

5. Patents must be depreciated over their full life. The respondent's regulations, implementing the statute, so provide. Where a group of patents are acquired, having varying lives, this requirement is met by applying the formula used in *Simmons Company v. Commissioner*, 8 BTA 631, 644, aff'd 33 F. 2d 75. Under this formula the allowable depreciation in each year is an amount which bears the same ratio to the total value of all the patents as the patent life expiring in that year bears to the total

unexpired life on the acquisition date. This is the only formula which spreads depreciation over the full life of all the patents and thus conforms to the respondent's regulations. Respondent's insistence that patent depreciation be taken instead on an "average life" basis would result in exhaustion of the basis for depreciation while seventeen of the thirty patents were still alive; the average life formula, as applied to these patents, is therefore contrary to respondent's own regulations. Since the formula which petitioner desires to use is admittedly proper, it should not be required to use some other formula which the respondent proposes.

6. The amount of depreciation by which patent basis was reduced to December 31, 1938 should be adjusted to reflect the correct cost basis and the correct method of spreading depreciation. This will not result in undeserved advantage to petitioner since it secured no tax benefit from the excessive depreciation charges. *Virginian Hotel Corporation v. Helvering*, 319 U. S. 523, does not preclude adjustment of depreciation on intangibles. Furthermore the present case involves merely correction of mathematical errors, where no tax benefit resulted therefrom.

7. The Tax Court is subject to the Administrative Procedure Act. It is not a court but is by law "an independent agency in the executive branch of the Government." The legislative history of the Act shows that Congress intended it to apply to *all* agencies, including the Tax Court. The Tax Court's procedures and judicial review of its decisions are therefore governed by that Act. Although the doctrine of *Dobson v. Commissioner*, 320 U. S. 489, does not in any event preclude full review of the issues in this case, the judicial review provisions of the Administrative Procedure Act provide additional independent grounds for such review here. *Lincoln Electric Co. v. Commissioner*, 162 F. 2d 379 (CCA 6th). The

Tax Court's failure to observe the procedural requirements of the Act is a further reason for reversal.

ARGUMENT

I

The Correct Basis for Depreciation of the Patents Which Petitioner Acquired When it Purchased the Assets of Mitchell of California Was the Difference Between What it Paid for All the Assets and the Agreed Value of the Tangible Assets.

The basis for depreciation of the patents which petitioner acquired when it purchased the assets of Mitchell of California is its cost of those patents. Sections 114 (a), 113 (b), 113 (a), Internal Revenue Code. This much is undisputed. Determination of petitioner's cost of the patents requires, first, a determination of petitioner's cost of all the assets, and then an allocation of the proper portion of this cost to patents.

A

Petitioner's cost of all the assets was \$3,100,000 because that is what it paid for them.

Harley L. Clarke bought the assets from Mitchell of California at one price and sold them to petitioner at another. The question in this case is petitioner's basis for those assets—not Harley L. Clarke's. Accordingly, petitioner's basis is to be determined by the price which petitioner paid—not by the price which Clarke paid in a prior transaction. Cost means "cost to the taxpayer." "A property may have a cost history quite different from its cost to the taxpayer." *Detroit Edison Co. v. Commissioner of Internal Revenue*, 319 U. S. 98, 102.

All of the evidence shows that petitioner's cost—the price which it paid for the assets, was \$3,100,000; there is no evidence whatever to the contrary. The Tax Court's findings of fact recite: (1) that on July 12, 1929, "a proposal signed by H. L. Clarke was made to petitioner to transfer to it all the properties, business, and assets of Mitchell of California for a stated consideration of \$3,100,000 in cash" (R. 40) (see also Stip. ¶3, R. 22); that on July 16, 1929, at a meeting of petitioner's board of directors, "a resolution was adopted accepting Clarke's July 12, 1929 proposal to sell the assets of Mitchell of California to petitioner for \$3,100,000 and authorizing its proper officers to execute all necessary documents to carry this resolution into effect" (R. 41) (see also Stip. ¶4, R. 22); (3) that on July 27 and 29, 1929, all of the assets of Mitchell of California were transferred to petitioner (R. 42, 44) (see also Stip. ¶5, R. 22); (4) that on August 2, 1929, petitioner's account at the Chase National Bank "shows a withdrawal of \$3,000,000, representing a check issued to Clarke," and that, on the same date, "H. L. Clarke's Account at Chase National Bank shows a deposit of petitioner's check for \$3,000,000" (R. 47). The revenue agent's computation, reproduced in the Tax Court's opinion (R. 51), shows "cost of assets—Mitchell Camera Co. of California * * *" at \$3,100,000.00. Counsel for respondent in his opening statement in the Tax Court, stated that the assets "were acquired by Mr. Clarke * * * for \$1,475,000" and later "transferred to the new corporation [petitioner] at a stepped-up basis of \$3,100,000.00" (R. 90). Mr. Clarke, whom the Government subpoenaed as a witness, testified that petitioner "paid \$3,100,000 out of its funds to acquire the assets from me under my offer of July 12, 1929" (R. 123), and that he received that consideration (R. 106, 124).

While apparently recognizing all this, the Tax Court held that petitioner's basis must nevertheless be deter-

mined by reference to the price which Clarke paid rather than the price which petitioner paid. The Tax Court's position seems to be that, because Clarke was an officer of petitioner, had helped to organize it, and, with Fox, owned other interests which controlled petitioner, any profit which Clarke made on a deal with petitioner must be excluded in determining petitioner's cost (R. 63, 64).

Of course Clarke made a large profit on this deal. These transactions took place in the year 1929 at the height of the speculative "boom" period. Clarke was a promoter, and large promotional profits in deals of this kind were commonplace. Petitioner's charter specifically provided that a director of the corporation should not be disqualified from dealing with the corporation "as a vendor, purchaser or otherwise," that such transactions should not be void or voidable in the absence of fraud, and that no director should "be liable to account to this Corporation for any profit realized by him from or through any such transaction" when ratified by the other directors (R. 38, 39). Clarke made a profit out of the transaction such as the charter contemplated, and was taxable on it. He made similar profits on his purchase and sale of the four lamp companies (R. 122, 125). These facts serve to strengthen, rather than to weaken, petitioner's contention that it actually paid \$3,100,000 for the assets—that is, Clarke's cost plus Clarke's profit. Clarke testified on cross-examination that after he contracted to buy these properties he could have transferred them to anyone (R. 125). Had he sold them to a company in which he had no interest, that purchaser's cost would of course have included Clarke's cost plus Clarke's profit. There is no more justification for excluding Clarke's profit from petitioner's cost, as respondent seeks to do, simply because Clarke's promotional activities may have put him in a better position to make this sale and realize this profit.

Clarke's transactions with, and interests in, other corporations are not relevant to, and do not alter the fact that he sold the assets in question to petitioner for \$3,100,000 and that petitioner paid him that price for the assets. Petitioner submits that this fact, which cannot be disputed on the evidence, conclusively determines petitioner's cost, and therefore basis.

In *Commissioner of Internal Revenue v. Matheson*, 82 F. 2d 380 (CCA 5), the taxpayer, who was co-executor and one of the legatees of his father's estate, agreed to accept certain stock of the estate at a price of \$130,700 as a credit against his legacy. On the date of the agreement, the market value of the stock was only \$111,200. Later, when taxpayer sold the stock, he claimed that his cost basis for measuring loss was \$130,700. The Commissioner argued that taxpayer would not have bought the stock at a price well above market value from any one else, that there must have been some personal motive or other consideration in his paying the difference, and that the correct basis was \$111,200. The Court, however, sustained the taxpayer, and held that the Board was not at liberty, without evidence, to suppose a different consideration for the stock from that which taxpayer paid.

The present case is much stronger from petitioner's point of view. Unlike the taxpayer in the *Matheson* case, appellant could not have gone into the market and purchased the assets for a lesser sum. In these circumstances, the Tax Court could not properly determine that petitioner's cost was something different from the price it concededly paid.

Nothing in *Dobson v. Commissioner*, 320 U. S. 489, precludes a full review of this question by this Court. The Supreme Court in the *Dobson* case left unchanged the principle that the Tax Court is still subject to review and reversal on questions of law, or on conclusions which

lack substantial support in the evidence. Whether petitioner's basis for assets which it purchased should be measured by the price which it paid, or the price which Clarke paid, is a clear cut question of law, for it involves a determination of what the statute means when it fixes "cost" as the basis for depreciation. Moreover, in this case, the evidence is clear and uncontroverted that petitioner paid \$3,100,000 for the assets. The Tax Court's contrary conclusion has no support whatever in the record, and is inconsistent with its own findings of fact (*supra*, p. 15). Cf. *Lawton v. Commissioner*, decided November 24, 1947 (CCA 6th).

B

Petitioner's cost of the patents was \$2,860,178.95—the difference between its cost of all the assets and the agreed value of the tangibles.

We have shown that petitioner's cost for all the Mitchell of California assets was \$3,100,000. The stipulated value of the tangible assets acquired in that transaction is \$239,821.05 (Stip ¶7, R. 23). The difference, or \$2,860,178.95, is what petitioner paid for the patents, and therefore the basis on which patent depreciation should be computed.

The respondent contends, however, and the Tax Court held, that the assets included very substantial good will value, to which a large part of petitioner's purchase price must be attributed (R. 94, 63).

This argument is apparently presented as an alternative to the argument that petitioner's cost of the assets was not \$3,100,000. In other words, respondent would apparently disallow, as part of petitioner's cost of the assets, the portion thereof representing Clarke's profit; or, if that cannot be done would allocate that portion of the cost to "good will" (R. 94). In reality, these arguments are not alternatives, but are different ways

of saying the same thing—that is, that the price which Clarke paid for the assets, rather than the price which petitioner paid, controls. For if, as seems clear from the respondent's own computation (R. 51), the assets did not include good will values in the hands of Clarke after he purchased them from Mitchell of California, they did not suddenly take on such values in the six weeks before he sold them to petitioner. The difference in the two prices was attributable not to good will, but to Clarke's profit. And, as we have shown under sub-head "A," there is no basis for excluding this profit from petitioner's cost. The question of such exclusion being one of law in determining what constitutes "cost" under the statute, the *Dobson* rule, as we have pointed out above (p. 18), is inapplicable here.

In any event, there was no evidence from which the Tax Court could find that any part of the price which petitioner paid for the Mitchell of California assets was for good will. All the evidence is to the contrary. George A. Mitchell, who had been the engineer in charge of production and development of Mitchell of California, testified that the business of that corporation in 1929 was based upon its patents; that it was the only company having a quiet camera which could be used with sound pictures, so that it had a monopoly on cameras for use with sound; that the company's position in 1929 was due to its patents, and that good will was not a factor in the business in 1929 (R. 99, 100). Mr. Clarke, testifying as a government witness, stated that the business of Mitchell Camera of California was the manufacture of motion picture cameras under patents; that his purpose in purchasing Mitchell of California was to obtain that corporation's patents and the right to build 70 millimeter cameras (R. 123). Mr. Fox testified that Mitchell Camera of California had previously built a wide film camera for him partly under its patents, and that the purpose of

buying the company was to obtain these patents; that Mitchell of California's value to Grandeur was the value of its patents; that his interest in the company was based entirely upon the patents which it owned—not upon its good will, machinery, or buildings (R. 131). The record shows that none of this testimony was disputed or contradicted in the slightest degree. The Tax Court's findings of fact are in accord with it, for it found that “all of [Mitchell of California's] business was in patented products manufactured under patents owned by it,” and “because of the patented features of the Mitchell camera, it was practically impossible to use any other camera in the production of ‘sound motion pictures’ * * *.” (R. 28). In these circumstances, the Tax Court was not at liberty to disregard the testimony of these witnesses. *Belridge Oil Co. v. Commissioner*, 85 Fed. 2d 762 (CCA 9); *C. H. Mead Oil Co. v. Commissioner*, 72 F. 2d 22, 25 (CCA 4th); *Lawton v. Commissioner*, CCA 6th, decided November 24, 1947; *Foran v. Commissioner*, CCA 5th, decided January 20, 1948.

The monopoly in the sound film field which Mitchell of California enjoyed solely because of its patents amply substantiates the testimony of the witnesses that the value of the company was in those patents—not in good will, or something else. In *Council Tool Co. v. Commissioner*, 8 B. T. A. 1046, it was held that where petitioner had eliminated competition by purchase of competitors assets, its success thereafter was attributable, not to good will of the former competitor, but to absence of competition. This result was reached although the resolution authorizing the purchase recited good will along with other assets, and although the purchasing corporation carried good will on its books for a number of years after the purchase.

The Tax Court's finding that there was substantial value in good will in the face of this strong, uncontro-

verted evidence is based upon book entries, and the fact that Mitchell of California was a successful corporation, recognized as producing "the best motion picture cameras available" and had back orders (R. 63). But errors of fact cannot be perpetuated because they are a part of an adjustment of tax liability for a prior year, or because they result from erroneous book entries. *Doyle v. Mitchell Bros.*, 247 U. S. 179, 187, *Isbell Porter Co. v. Commissioners*, 40 F. 2d 432 (CCA 2d). This Court has pointed out that:

"As is well known, book values assigned to corporate assets are often arbitrary, and their general unreliability is everywhere recognized." *Spreckels-Rosekrans Investment Co. v. Lewis*, 146 F. 2d 982 (CCA 9).

Mitchell of California's success and recognition in the motion picture camera field, to which the Tax Court refers, instead of showing that the company had or sold good will as a separate asset, emphasizes the value of the company's camera patents. The Tax Court expressly found that the company's monopoly position and back orders came about "because of the patented features of the Mitchell camera" (R. 28). Any other monopoly owner of these patents would have had similar success, recognition, and orders. Without these patents, Mitchell of California would have had none of these things, nor could it have obtained or filled its orders. In this situation, good will could have no separate existence, for such value as the business had lay in the value of the patents.

Moreover, the evidence is undisputed that Clarke and Fox gave no thought to good will in making this purchase. They were interested only in patents, and it was for patents alone that the consideration was paid (R. 123, 131).

The authorities are agreed that where a mixed aggregate of tangible and intangible assets are acquired for one consideration, and the business is one dependent for earnings upon patents, the cost to the purchaser of the patents is the price paid over and above the tangibles.

In *Republic Steel Corp. v. U. S.*, 40 F. Supp. 1017 (Court of Claims), plaintiff's subsidiary had purchased all of the property and assets of a company called Steel & Tubes No. 1 at a price of \$19,556,992.43. It was undisputed that the tangible assets were worth \$7,094,332.04. The question concerned the cost, as basis for depreciation, of the patents included in the assets. The plaintiff claimed that the balance of the purchase price above the tangibles was paid for the patents, while the defendant claimed that part of this price was for good will. The Court of Claims sustained the plaintiff's position. In this connection, the Court said: (40 F. Supp. at 1023):

“* * * Apparently Steel and Tubes No. 1 did not consider that it had any good will separate and apart from its patents; in other words, if it disposed of its patents, it would not have any good will. Its president so testified, and it gave no value to it on its books. The plaintiff says it placed no value on it in determining whether or not to pay the price demanded.

“But the defendant says the parties overvalued the patents, that they were not worth the sum at which the parties valued them, and it argues at length in support of this proposition. This may or may not be true; they may not have been worth what the parties thought they were. But the fact remains that they were purchased on the parties' valuation of them, and not on their actual value. The amount of \$19,556,992.43 was paid for all the assets, the tangible assets were worth \$7,091,332.04, leaving \$12,462,660.39 as the price paid for the intangible assets. The only intangible assets regarded by the parties as of any value were the patents, so it must follow that this sum was paid for the pat-

ents. It may be that the seller's good will really did have a value, but if the parties did not think so and, in computing the price to be paid, gave it no value, it must be eliminated from consideration in computing the amount paid for the other assets."

Petitioner's case is on all fours with the *Republic Steel* case. As in that case, the parties here did not consider that Mitchell of California "had any good will separate and apart from its patents" and gave no consideration to good will in making the purchase (R. 123, 131). The crux of that case, equally applicable to this one, is embodied in the Court's statement that—

"The only intangible assets regarded by the parties as of any value were the patents, so, it must follow that this sum [balance over tangibles] was paid for the patents."

In *Illinois Pipe Line Company v. Commissioner*, 37 BTA 1070, 1079, taxpayer purchased assets of the Ohio Oil Co. consisting of pipe line properties for \$20,000,000 worth of stock. Taxpayer claimed that the cost of the depreciable assets was \$18,799,415, while the Commissioner claimed that their cost was only \$10,191,412.14, attributing the difference to "going concern" value. The Board sustained the taxpayer. It held that the parties never intended to purchase intangibles; that—

"The evidence * * * shows that no part of the purchase price was paid for intangibles and, further, that any 'going concern value' attached to the line exhausted with the line itself."

The evidence in the present case, with respect to the patents, is the same: the parties did not intend to buy good will; anything resembling good will was not a separate asset but inhered in the patents, and became exhausted along with the patents.

In two later cases, the Tax Court followed the *Republic Steel* case, *supra*, holding that the total price which the taxpayer had paid for an aggregate of assets was attrib-

utable to patents or other depreciables, and that no part thereof was attributable to good will, where witnesses had testified that good will was not considered a separate asset, that all the value was thought to be attributable to the other assets and that there was no intention to buy or sell good will as such.

American Fork & Hoe Co. v. Commissioner, T. C. Memo Op., Sept. 22, 1943, Docket Nos. 108334, 108503, 2 TCM 842, 846, 847;

Addressograph-Multigraph Corp. et al. v. Commissioner, T. C. Memo Op., Feb. 5, 1945, Docket Nos. 109181-108187, 111395, 4 TCM 147, 155.

On the evidence, a similar conclusion is required in the present case.

C

The Tax Court erred in sustaining a deduction of \$294,842.41 from total cost in arriving at the cost of patents, when a value of \$239,821.05 was stipulated.

The respondent deducted, in arriving at petitioner's cost of the patents, \$294,842.41 for "net assets other than good will" (R. 51, 65), whereas a value of \$239,821.05 for the tangible assets was stipulated (Stip #7, R. 23). The difference is \$55,021.36, and, as the facts show, resulted from a mathematical error—not from a deliberate allocation of values.

The Tax Court sustained respondent's action on the ground that the agreement of the former owners of the business not to compete, and the "large backlog of contracts," might be worth this difference (R. 66).

This falls on analysis. Mr. Mitchell testified that the "agreement not to compete" was merely a routine "customary agreement" (R. 102). It was particularly unimportant in this case since both of the former owners,

Boeger and Mitchell, agreed to and did continue with the new company after they sold out (R. 34, 99) and Mitchell testified that he was employed by the new company for five years—the full length of the agreement not to compete (R. 56, 102). There was no testimony by the respondent that such agreement had a value. Similarly, the Tax Court relied in part on the “large backlog of unfilled orders” to justify its sustaining the good will item (R. 63); yet, it relied on this same item (this time called “large backlog of contracts”) to justify the figure placed on “net assets other than good will” (R. 66). This is sheer duplication; it is a case of blowing hot and cold at the same time.

The plain fact is that there were no such “assets other than good will.” The origin of this \$55,021.36 item is clearly traceable to an error in the revenue agent’s 1934 computation (R. 51).

The net tangible assets reflected on petitioner’s 1929 balance sheet (R. 49) add up to \$239,821.05.

Land		\$35,535.40
Buildings		73,938.48
Machinery & Equipment	\$91,009.70	
Less: Depreciation Reserve	12,760.82	78,247.88
<hr/>		
Land held for sale		2,050.32
Accounts Receivable		2,815.00
Inventory		50,896.77
<hr/>		
Total		\$243,483.85
Less:		
Accounts Payable	2,815.00	
Accrued payroll	847.80	
<hr/>		3,662.80
<hr/>		
Net tangible assets		\$239,821.05

Patents were carried on this balance sheet at \$55,021.36 (R. 49). In the 1934 computation, the agent valued patents as follows (R. 51):

Actual value paid by Harley Clarke for	
total assets	\$1,475,000.00
Less: Net assets other than good will	294,842.41

Considered as value of patents\$1,180,157.59

Breaking down the \$294,842.41 item to show its components, the computation becomes:

Actual value paid by Harley Clarke for	
total assets	\$1,475,000.00
Less net assets other than good	
will	
Tangibles	\$239,821.05
Book value of patents	55,021.36
	<hr/>
	294,842.41

Considered as value of patents\$1,180,157.59

The agent in his 1934 computation simply erroneously added the book value of the patents to the tangibles in arriving at what he considered the actual value of the patents. Since his purpose was to compute the actual value of the patents, he should, of course, have eliminated their book value as follows:

Actual value paid by H. L. Clarke for	
total assets	\$1,475,000.00
Less net value of tangible assets	239,821.05

Considered as value of patents\$1,235,178.95

Clearly, therefore, the \$55,021.36 item, which the Tax Court says may have been due to the agreement not to compete and to the backlog of orders, is in fact simply the value at which patents were originally carried on the books, which erroneously found its way into the agent's computation.

It is taxing coincidence beyond the bounds of credibility to suggest that the identical figure, to the penny, is both the 1929 book value of the patents and the value of the intangibles on which the Tax Court relies. Therefore,

whether petitioner's basis is to be measured by the price which it paid for the patents, or, as respondent contends, by the price which Clarke paid, it is clear that, at the very least, the basis must be adjusted to include this \$55,021.36 item.

The *Dobson* rule of course has no application to the Tax Court's conclusion on this point, both because the evidence does not support such a conclusion and because, as we have shown, it has its origin in pure mathematical error.

II

If Petitioner's Basis Is to Be Measured by Clarke's Cost Respondent's Computation Must Be Adjusted to Show Clarke's True Cost.

The theory of the respondent, and of the Tax Court, was that petitioner's basis must be measured by the price which Clarke, rather than petitioner, paid for the assets. Petitioner, in the first section of this brief, has shown why it believes this position to be untenable. However, if, contrary to petitioner's contention, this Court should accept respondent's theory on this branch of the case, then, at the very least, Clarke's cost, as computed by respondent, must be corrected in two respects: (1) to eliminate the mathematical error of \$55,021.36 which the agent made in computing the "value of patents"; and (2) to reflect the commissions which Clarke paid in order to acquire the assets.

The first adjustment, the \$55,021.36 item, has been discussed at length immediately hereinbefore, in section I-C. The commissions item will accordingly be discussed here.

Harley L. Clarke testified, as a government witness, that he paid some "very good sized commissions" to acquire the assets of Mitchell of California. He placed these commissions at between \$350,000 and \$400,000 (R. 117,

118, 122). This, of course, was in addition to the \$1,475,000 which he paid to the owners of Mitchell of California for the assets themselves (R. 122). His testimony on this point was not questioned or disputed in any way.

The Tax Court, however, has used as Clarke's cost of the assets only the \$1,475,000 figure and has failed to take into account this large commission item (R. 64, 65).

Commissions paid in acquiring property must of course be added to the price paid in determining the cost basis. *Helvering v. Winmill*, 305 U. S. 79, *Tonningsen v. Commissioner of Internal Revenue*, 61 F. 2d 199 (CCA 9th); *Young v. Commissioner of Internal Revenue*, 59 F. 2d 691 (CCA 9th).

The Tax Court has sought to justify the omission of the commissions from Clarke's cost on the ground that "to whom they were paid or for what service rendered, we are not advised" (R. 64), and has apparently confused these commissions with a different commission item of \$100,000 appearing in a Senate Committee exhibit (Ex. G), (R. 65). But Clarke, as a government witness, testified that the \$350,000 to \$400,000 commissions were "outside of what appears on the exhibit" (R. 118). And he stated specifically that he paid these commissions "on the Mitchell Camera Corporation acquisition" (R. 122, 117, 118). It makes no difference, for present purposes, to whom the commissions were paid; the important fact is that they were paid for acquiring Mitchell assets. But if elaboration were desired, the respondent, whose witness Clarke was, should have questioned him further, for this was testimony affecting respondent's defense of his prior action. The burden shifted to him to overcome the testimony of his own witness if he could. The Tax Court does not intimate that it discredits Clarke's testimony that he paid these commissions, even if it were at liberty to do so. It makes no finding either way. It says, merely, that "more evidence than this is required

upon which to base a finding of additional cost by reason of commissions paid." (R. 65). But the evidence is clear, unequivocal, and undisputed that Clarke paid \$350,000 to \$400,000 in commissions in order to acquire the Mitchell of California assets. No more than this is either necessary or relevant to support petitioner's position. The commissions must therefore be included in computing Clarke's cost of the assets, and it was clear error to exclude them. Cf. *Cohan v. Commissioner*, 39 F. 2d 540 (CCA 2d); *Isbell Porter Co. v. Commissioner*, 40 F. 2d 432 (CCA 2d).

The *Dobson* rule does not preclude reversal where the Tax Court has simply disregarded, though it has not discredited, unequivocal and unrefuted testimony adverse to the party who called the witness. Moreover, the Tax Court did not find that the claimed commissions were not paid. It based its decision on what it regarded as insufficient evidence (R. 65). Whether the evidence was sufficient to justify a finding that the commissions were paid is of course a question of law which this Court may review.

In any event, if the Tax Court deemed more evidence on this issue essential to a decision it should have afforded the parties an opportunity to supply it, or have made a fair approximation under the *Cohan* rule. Therefore if this Court, contrary to our contentions, likewise deems additional evidence important to a decision, the case should be remanded either for an allowance of an approximation or for a re-hearing to supply the data in order that justice may be done. *Doernbecher Mfg. Co. v. Commissioner*, 80 F 2d 573, 574 (CCA 9th); *Lewis et al, Trustees v. Commissioner*, 160 F 2d 839 (CCA 1st).

III

The Depreciation of the Patents Should Be Computed by Reference to the Full Life of All the Patents Rather than on a Composite Average Life Basis.

Section 23 of the Internal Revenue Code (1939) provides that—

“In computing net income there shall be allowed as deductions:

“(1) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *”

The respondent's regulations lay down the proper rules for computing depreciation under this provision of the law. Reg. 103, Sec. 19.23 (1)-1 states that:

“* * * The proper allowance for such depreciation is that amount which should be set aside for the taxable year in accordance with a reasonably consistent plan (not necessarily at a uniform rate), whereby the aggregate of the amounts so set aside, plus the salvage value, will *at the end of the useful life of the depreciable property*, equal the cost or other basis of the property * * *.” (Emphasis added.)

The provisions of respondent's “Bulletin F” (272) (revised January 1942) are substantially the same. Similarly, Reg. 103, Sec. 19.23 (1)-7, dealing specifically with patents or copyrights, says:

“* * * The allowance should be computed by the apportionment or other basis of the patent or copyright *over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be.*” (Emphasis added.)

These regulations recognize, and indeed require, depreciation of patents over their entire life, which is of course the

17 year statutory life. And, as this Court said in *Douglas County Light & Water Co. v. Commissioner*, 43 F. 2d 904, 905 (CCA 9th):

“A Treasury regulation has the force and effect of law unless it is in conflict with an express statutory provision.”

The regulations undoubtedly reflect Congress' intent, in providing for a depreciation allowance, that depreciation be spread over the entire life of the assets. The Supreme Court has pointed out that:

“Congress has provided for deductions of annual amounts of depreciation which, along with salvage value, will replace the original investment of the property *at the time of its retirement*.” (Emphasis added). *Virginian Hotel Corp. v. Helvering*, 319 U. S. 523, 528.

This is the only sound and reasonable basis for taking depreciation, both from an accounting and economic point of view. *Detroit Edison Co. v. Commissioner of Internal Revenue*, 319 U. S. 98, 101.

Where a group of patents are acquired, having varying lives, the requirement that depreciation be spread over their full lives is met by following the formula which the Board of Tax Appeals adopted in *Simmons Company v. Commissioner*, 8 BTA 631, 644 (aff'd 33 F. 2d 75, cert. den. 280 U. S. 588). Under that formula, the allowable depreciation deduction in each year would be an amount bearing the same ratio to the total value of all the patents as the patent life expiring in that year bears to the total unexpired life on the date of acquisition. Depreciation is thus spread over the entire life of all the patents. This is the only formula which will satisfy the quoted regulations and is the one which appellant wishes to use in this case. The respondent, on the other hand, would require that petitioner's depreciation be taken over a period of the average lives of the patents from the date of acquisition—12.3666 years.

The thirty patents acquired by petitioner had life expiration dates extending from 1936 to 1950; *seventeen of these patents will expire after the last year in which respondent has allowed depreciation* (Ex. 16). Clearly, respondent's insistence that the patents be depreciated on an average life basis cannot be squared with his regulations, requiring depreciation to be spread over the entire "life of the patent."

The cases upon which the Tax Court relies to sustain the average life formula (R. 67) all involved entirely different issues from that in this case. In *Union Metals Mfg. Co.*, 4 BTA 287, and *Syracuse Food Products Corp.*, 21 BTA 865, the Board merely held that a group of patents need not be valued and depreciated individually, but might be depreciated as a group over their average lives. In *Prophylactic Brush Co.*, 25 BTA 676, the Board held that, where an original invention was patented in 1909, and improvements in 1915, depreciation would be over the average life of both, rather than over the life of the last patent as contended for by the Government. In these cases, the parties were agreed that if the patents were to be considered as an aggregate, depreciation would be on the average life basis. While the Board in these cases does tolerate or "recognize" the average life formula, as the Tax Court says (R. 67), it did not have before it, and did not decide, the issue now presented; namely, whether a taxpayer who wishes to depreciate patents over their entire useful life as the regulations require may instead be compelled to use an average life formula which exhausts his basis long before the end of the life of the patents.

This Court had an analogous situation presented in *Wells Fargo Bank & Union Trust Co. v. Commissioner*, No. 11502, decided August 27, 1947. The question there was whether the cost of cancellation of a lease for the purpose of obtaining a new lease should be amortized over

the term of the new lease, or the unexpired term of the old lease. The Tax Court, relying on earlier Board cases, has held that the cost must be amortized over the unexpired term of the old lease. This Court reversed, holding that the cost of cancellation was amortizable over the term of the new lease. With reference to the Board cases on which the Tax Court had relied in reaching a contrary conclusion, this Court said:

“While it may be admitted that the Tax Court has gradually evolved such a rule [amortization over unexpired term of old lease], yet * * * the question of how the cost of cancellation was to be amortized was never presented. In all the cases cited in the Tax Court opinion, the taxpayer argued that the cost of cancellation should be deductible as an ordinary expense of doing business while the Commissioner claimed that the amount was amortizable. *Neither side ever raised the issue of the period of amortization.* * * *.” (Emphasis added)

Similarly, in the present case, *the issue now presented, as to the period of depreciation, was never raised or decided in the Board cases upon which the Tax Court relies.* Those cases are therefore not persuasive here. Moreover, so far as appears, the question has never been raised in or decided by an appellate court. Petitioner submits that for reasons heretofore stated it should now be decided in accordance with its position.

The *Wells Fargo case*, supra is important here in another respect. There, as here, the taxpayer contended that amortization should be spread over one period while the Commissioner contended for another. Plausible argument could be, and was, advanced in support of both positions. Yet this Court held that the “decision of the Tax Court in this matter denying to petitioner the right to amortize the cost of cancelling the old lease over the terms of the new lease, should be and hereby is reversed.” Similarly, in the present case, even if the average life formula is one

possible method of depreciating patents, yet it is unquestioned that the "full life" formula set forth in the *Simmons* case is also a proper and reasonable method, and the only method which spreads the basis over the full life of the patents. The taxpayer in this case, therefore, like the taxpayer in the *Wells Fargo* case, should not be denied the right to use an admittedly proper method of depreciation simply because the respondent desires it to use some other method.

But the Tax Court seems to imply that petitioner is estopped to depreciate on a full life basis now because for some years it used the average life formula fixed in the revenue agent's 1934 computation. It erroneously relies on *Virginia Hotel Corporation v. Helvering*, 319 U. S. 523 for this proposition (R 67). The Supreme Court held in that case that where the Commissioner had determined the useful life of equipment to be greater than petitioner had claimed, resulting in a lower annual rate of depreciation, the petitioner might not apply this lower rate to the prior years 1931-1936 (years not in controversy) so as to create a higher remaining basis for depreciation in the taxable year (1938). This was because depreciation at the old rate for prior years had been "allowed" under sec. 113 (b)(1)(B) of the Internal Revenue Code, by acceptance of the former returns without challenge, 319 U. S. at 527. The issue there related to *cumulative* depreciation rather than to *current* depreciation.

Whether the *Virginian Hotel* doctrine should bar petitioner from revising its basis for the prior years 1932 through 1938 to reflect the depreciation properly allowable is a question which is discussed in a subsequent section of this brief (*infra* p. 36). Whatever the answer to that question may be, it is certainly clear that the *Virginian Hotel* case has no application to the years 1939 through 1941 since these are the years as to which petitioner's tax liability is here in issue. These years are before the Court in

this proceeding and are still open to depreciation adjustments of any kind, for as to them no depreciation has been finally "allowed." There can therefore be no question of "estoppel," or otherwise, as to petitioner's right to take depreciation on a full life basis under the *Simmons* formula for the years 1939 through 1941.

The total life of the patents acquired by petitioner was 4452 months, with 212, 204, and 204 months being exhausted in the years 1939, 1940 and 1941, respectively (Ex. 16). Applying the *Simmons* rule to \$2,860,178.95, petitioner's cost of the patents, the allowable depreciation for these years would be:

1939	\$136,199.40
1940	131,059.80
1941	131,059.80

In contrast with the above, respondent has allowed depreciation as follows:

1939	\$ 95,430.50
1940	95,430.50
1941	13,637.89

(These figures differ from those shown in respondent's notice of deficiency and the Tax Court's opinion (R 55) because in the Rule 50 computation the respondent acknowledged that depreciation allowed to December 31, 1938, on the original patents should be \$975,658.70 instead of \$1,035,539.75 as shown in the notice of deficiency (R 14) and the Tax Court's opinion (R 55). This accounts for most of the difference between the deficiency originally proposed (\$73,478.94) (R 26) and the amount fixed in the Tax Court's decision (\$47,720.78) (R 68).

The petitioner submits that, whatever its basis be for the patents, it is entitled to use the *Simmons*, or full life, method of depreciation.

IV

The Cumulative Depreciation on Patents to December 31, 1938, Should Be Adjusted to Reflect the Correct Amount of Depreciation for Prior Years.

In his 1934 computation, respondent determined that an annual patent depreciation of \$95,430.50 was allowable on an average life formula of 12.666 years (R. 51). Petitioner has shown in prior sections of this brief that the respondent erred both in the cost basis which he fixed for the patents, and in requiring depreciation on an average life, rather than full life, formula. Therefore, the amount of depreciation by which the basis was reduced as of December 31, 1938, should now be adjusted to reflect the correct cumulative depreciation on the correct basis of the patents, whether computed by the full life or average life formula.

Such correction will not result in a windfall or undeserved advantage to petitioner, since it sustained substantial losses during the years 1932 through 1938 and therefore secured no tax benefit from the excessive depreciation charges (R 52, 53). (There might be a small tax benefit for the single year 1936, but petitioner does not contend for correction to the extent that this would result in tax benefit having been realized.) The government will not therefore be prejudiced in any way if the basis is now made to reflect the amount of depreciation properly allowable in prior years.

Nor is *Virginian Hotel Corporation v. Helvering*, 319 U. S. 523, a bar to correction of these past errors. The Supreme Court held in that case that a taxpayer who in prior years had taken depreciation on the basis of a short life estimate could not, upon determination of a longer life estimate, go back and revise his basis to reflect the new estimate. There is no question in the present case of revising the estimated life of assets, since patents have a fixed statu-

tory life of seventeen years. Obviously, in the present case, the petitioner's taking depreciation at an average of \$107,000 (R. 52, 53) when the respondent in 1934 had fixed a rate of \$95,430.50 (R. 51), with no resulting tax benefit, was due to pure error. Likewise, if, as petitioner believes, the *Simmons* formula, rather than the average life formula, should have been used, the resulting rate of depreciation is based on mathematical error. Nothing in the *Virginian Hotel* case holds or implies that errors of this sort, which resulted in no tax benefit, are beyond correction. The situation here is no different tax-wise from that where an erroneous figure is listed for depreciation through typographical error. It cannot be said that depreciation is "allowed" within the meaning of the statute (§ 113 (b) (1) (B) 1RC), merely by acceptance of the return, where the figure listed for depreciation is based upon pure mistake and the correction of the figures would have made no difference in the tax.

Moreover, the case of *Rainier Brewing Company v. Commissioner*, 7 T. C. 162 (affirmed by this Court January 9, 1948), indicates that the *Virginian Hotel* case does not require that unallowable depreciation be deducted where intangibles are involved. In the *Rainier* case, the taxpayer's predecessor was allowed in prior years unallowable obsolescence on a trade name. The Commissioner contended that since he had allowed the obsolescence in the audit of the returns, the taxpayer could not restore the unallowable obsolescence to the basis for the property. The Tax Court disagreed, however, holding that the *Virginian Hotel* case was "not controlling" and "is distinguishable on its facts and the rationale of that decision is not applicable here." 7 T. C. at 178. The Court accordingly limited the amount by which prior obsolescence reduced the basis to the actual tax benefit resulting from the erroneous deduction.

Petitioner submits that here, as in the *Rainier* case, the patent basis may and should be corrected to reflect only

the depreciation properly allowable, except to the extent that excessive depreciation actually resulted in tax benefit.

The *Dobson* rule is clearly inapplicable to this issue, since the question here is one of pure statutory construction. As in the *Virginian Hotel* case, *supra*, that question is, of course, open to appellate review.

V

The Tax Court Is an Agency Within the Meaning of the Administrative Procedure Act, and Its Procedures and the Reviewability of Its Decisions Are Governed by that Act.

The Administrative Procedure Act (60 Stat. 237, 5 U. S. C. § 1001) prescribes procedures which agencies of the United States must follow in formulating decisions, and also sets forth the scope and standard of judicial review of such decisions. Both of these features of the Act are important in this case if the Tax Court is an agency subject to the Act. Petitioner earnestly submits that it is such an agency, and that both its procedures and the reviewability of its decision are therefore governed by the provisions of that Act.

A

The Tax Court is an agency within the Administrative Procedure Act.

The Administrative Procedure Act applies to all agencies of the United States. Section 2 (a) of that Act defines "agency" to mean:

"each authority (whether or not within or subject to review by another agency) of the Government of the United States other than Congress, the courts, or the governments of the possessions, Territories, or the District of Columbia."

The Tax Court is clearly not a court in any accurate sense. The Tax Court's predecessor, the Board of Tax Appeals, was created by the Revenue Act of 1924 (43 Stat. 253, 338) as "an independent agency in the executive branch of the Government." The Internal Revenue Code (§ 1100) when enacted, described the Board in the same way.

The Supreme Court, in *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 725 said:

"The Board of Tax Appeals is not a court. It is an executive or administrative board, upon the decision of which the parties are given an opportunity to base a petition for review to the courts after the administrative inquiry of the board has been had and decided."

The change of the Board's name to "Tax Court," and the designation of its members as "judges," in no way affected the status of the tribunal as an independent agency in the executive branch. The Committee Report (H. R. Rept. No. 2333, 77th Cong. 2d sess. pp. 172, 173) explaining § 504 of the Revenue Act of 1942 (56 Stat. 957) which effected the changes says:

"This section merely changes the names by which the Board of Tax Appeals, its chairman and its members are known. No change is made in its status. The Board, which will hereafter be known as the United States Tax Court, is continued as an independent agency in the executive branch of the Government. *Thus its status as an executive or administrative board is unchanged.* *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, 725 (1929). * * * The Board and its divisions will continue to have the same jurisdiction, powers and duties as provided by existing law." (Emphasis added)

Both the Supreme Court and Circuit Courts of Appeal have recognized, since the Board's change of name to Tax Court, that the tribunal is still "an independent agency in the executive branch of the Government." *Commissioner*

v. *Gooch*, 320 U. S. 418, 420; *Dobson v. Commissioner*, 320 U. S. 489; *Hutchings-Sealy National Bank v. Commissioner*, 141 F 2d 422 (CCA 5th).

The Tax Court, like other agencies, is therefore clearly subject to the Administrative Procedure Act unless Congress intended to exempt from the Act not only tribunals which are courts in fact but also an administrative agency which is called a court. But neither the Act itself nor its legislative history evinces any such intent. On the contrary, they indicate that Congress intended the Act to apply to the Tax Court as fully as to other agencies of the government.

The committee reports make clear that the definition of "agency" in the Act excludes only "legislative, judicial, and territorial authorities" and includes "any other 'authority' ". Legislative History, Administrative Procedure Act, Senate Document No. 248, 79th Cong. 2d sess., pp. 196, 252 (hereinafter cited Legis. Hist.). Congress' intention to exclude "judicial authorities" from the operation of the Act does not justify exempting a body which it had previously set up as "an independent agency in the executive branch of the Government." Agencies in the executive branch are precisely what the definition is designed to include. It cannot be assumed that Congress, when it enacted the Administrative Procedure Act and made it apply to all agencies, was ignorant of its own law of a few years before setting up the Tax Court as an independent agency in the executive branch.

A Senate Judiciary Committee Print, (Legis. Hist. p. 12), explaining the derivation and meaning of the various provisions of the Administrative Procedure Act, says that the definition of "agency" in that Act is substantially the same as in the Federal Register Act. This is reasonable, since agencies must utilize the Federal Register in complying with several of the provisions of the Administrative Procedure Act. The Federal Register Act, like the Adminis-

trative Procedure Act, defines "agency" broadly to include all authority in the executive branch but to exclude specifically the legislative and judicial branches (Sec. 4, 49 Stat. 500, 44 U. S. C. 304). The Tax Court, both before and after its change in name, has regarded itself as an "agency" rather than a "court" within the Federal Register Act, for it has consistently published its rules as "agencies" under that Act are required to do. (See Title 26, Chapter III of Code of Federal Regulations, and annual supplements; also 1 CFR § 2.2(d)). Yet, in view of the inter-relation of the two Acts, and particularly of their respective definitions of "agency" it seems clear that if the Tax Court is an agency for purposes of the Federal Register Act, it is equally an agency for purposes of the Administrative Procedure Act.

Further examination into the history of the Administrative Procedure Act bears out petitioner's position that the Tax Court is an agency subject to the Act.

The Attorney General's Committee on Administrative Procedure, appointed in 1939 at the request of the President to investigate the "need for procedural reform in the field of administrative law," made exhaustive studies covering most of the agencies in the executive branch. The results of its studies were published in a "Final Report of the Attorney General's Committee on Administrative Procedure," (Sen. Doc. No. 8, 77th Cong. 1st sess. (hereinafter cited "Final Report")), and twenty-seven monographs which it prepared on individual agencies. The Board of Tax Appeals was one of the agencies which the Committee studied, and one of its monographs discusses the Board. Sen. Doc. No. 10, part 9, 77th Cong. 1st sess. pp. 69, 83. Nothing in the Final Report or the monograph indicates that the Committee regarded the Board as unique or outside its principal recommendations. The contrary would seem to be clearly true (see Final Report, p. 167).

In a "Manual" which the Department of Justice has prepared on the Administrative Procedure Act, the present Attorney General points out (p. 5) that

"The main origins of the present Administrative Procedure Act may be found in that [Final] Report, and in the so-called majority and minority recommendations submitted by the Committee."

And again, on page 8 of the "Manual," it is stated that

"The legislative history of the Administrative Procedure Act really begins with the Final Report of the Attorney General's Committee on Administrative Procedure."

The Congressional Committee Reports also point out that, in preparing the bill which became the Administrative Procedure Act, careful attention was paid to the earlier work of the Attorney General's Committee. (Committee Reports, Legis. Hist. pp. 190, 246.). A Senate Judiciary Committee "print" was issued showing the parallel between each provision of the new proposed law and the recommendations of the Attorney General's Committee (Legis. Hist. p. 11 et seq.).

In the absence of any clear indication to the contrary it is reasonable to assume that the coverage of agencies by the Administrative Procedure Act is at least as broad as that envisaged by the studies and recommendations of the Attorney General's Committee.

Had the name of the Board of Tax Appeals remained unchanged it would seem to be beyond serious dispute that the Administrative Procedure Act applied to it. But every reason for applying the Act to the tribunal were it still called a Board is equally present now that it is called a Tax Court, since the change in name did not make the tribunal any the less an agency or otherwise affect its functions (see *supra* p. 39). Congress' purpose, in enacting a uniform code of procedure and standard of judicial review for all agencies of the government, is as equally

applicable to the Tax Court as to other agencies. Had Congress intended to exempt the Tax Court, it would have been easy enough to say so specifically.

As against all this, the argument that the Tax Court is not subject to the Act is based upon a "dictum" of the Attorney General in a letter to Senator McCarran while the bill was pending. Commenting on the exemption of courts in §2 of the Act, the Attorney General said—

“ ‘Court’ includes the Tax Court, Court of Customs and Patent Appeals, the Court of Claims and similar courts. This act does not apply to their procedure nor affect the requirement of resort thereto.”
Legis. Hist. p. 224.

The Attorney General does not indicate how he arrives at this conclusion with respect to the Tax Court. The Court of Customs and Patent Appeals and the Court of Claims are quite different; they are legislative courts of record provided for in the Judicial Code (28 U. S. C. 301, 241), and have been so recognized by the Supreme Court. *Ex Parte Bakelite Corp.*, 279 U. S. 438; *Williams v. United States*, 289 U. S. 553. It appears that the Attorney General was misled by the word "court." In any case, it is clear that he had not carefully considered the problem, and his "dictum" is entitled to no weight in construing the legislative intention in view of the strong evidence to the contrary.

The Sixth Circuit Court of Appeals in *Lincoln Electric Co. v. Commissioner*, 162 F 2d 379, held, in line with petitioner's contentions here, that the Tax Court is an agency subject to the Administrative Procedure Act, and that judicial review of the Tax Court's decisions would be governed by that Act rather than by the *Dobson* rule. It reiterated this view in *Dawson v. Commissioner*, decided September 22, 1947. Petitioner respectfully submits that this Court should take the same view.

B

The Judicial Review Provisions of the Administrative Procedure Act have broadened this Court's power to review Tax Court decisions.

Section 10 (e) of the Administrative Procedure Act provides that the reviewing court shall set aside agency action, findings, and conclusions "unsupported by substantial evidence," and that—

"In making the foregoing determinations the court shall review the whole record or such portions thereof as may be cited by any party * * *."

The House Committee report (Legis. Hist. p. 279) explains these provisions as follows:

" 'Substantial evidence' means evidence *which on the whole record is clearly substantial, plainly sufficient to support a finding or conclusion * * * and material to the issues.* * * * Although the agency must do so in the first instance, under this bill *it will be the duty of the courts to determine in the final analysis and in the exercise of their independent judgment whether on the whole of the proofs brought to their attention the evidence in a given instance is sufficiently substantial to support a finding, conclusion or other agency action or inaction.*" (Emphasis supplied).

As the Sixth Circuit Court of Appeals pointed out in the *Lincoln Electric* case, *supra*, appellate power of review "doubtless has been broadened" by these provisions. Although we have shown in previous sections of this brief that the *Dobson* rule does not preclude full review of the issues in this case in any event, the Administrative Procedure Act is thus an additional and independent reason why petitioner is entitled to such review. For the Act has clearly restored to appellate courts the powers of review which they exercised before the limitations of the *Dobson* rule were imposed. *Lincoln Electric Co. v. Commissioner, supra.*

C

The Tax Court failed to observe the procedure provisions of the Administrative Procedure Act.

Petitioner on July 24, 1947, filed a motion to vacate and set aside the findings and opinion of the Tax Court on the ground that the Tax Court is an "agency" governed by the Administrative Procedure Act, and petitioner had no opportunity, as required by that Act, to submit its objections and exceptions to the Tax Court's "initial" decision before it became final (R 70). The Tax Court denied this motion.

Section 7 (a) of the Act provides that cases may be heard by: "(1) the agency, (2) one or more members of the body which comprises the agency, or (3) one or more examiners appointed as provided in this Act." Section 8 (a) provides that in cases where the agency itself has not presided at the reception of the evidence the officer who presided shall make an initial or recommended decision, from which there shall be an opportunity for appeal to, or review by, the agency. Section 8 (b) provides that a party shall have an opportunity to submit exceptions to the decision or recommended decision of the hearing officer prior to agency review. On this phase of the Act the Attorney General's interpretation seems correct; he explains this provision as follows (Legis. Hist. p. 229):

"Section 8(b) Prior to each recommended, initial, or tentative decision parties shall have a timely opportunity to submit proposed findings and conclusions, and prior to each decision upon agency review of either the decision of subordinate officers or of the agency's tentative decision, to submit exceptions to the initial, recommended, or tentative decision, as the case may be. * * * "

Since the Tax Court judge who heard this case is a member "of the body which comprises the agency," rather than the agency itself, petitioner was entitled, under the above provisions of the Act, to file exceptions to his report,

and to opportunity for review by, or on behalf of, the Tax Court itself. Because the Tax Court takes the position, erroneously petitioner submits, that it is a court rather than an agency, petitioner was accorded neither of these rights. This denial is clearly reversible error under section 10 (e) (B) of the Act which directs reviewing courts to

“hold unlawful and set aside agency action, findings, and conclusions found to be * * * (4) without observance of procedure required by law * * * .”

If it is thought that for some reason the Tax Court should be exempted from the requirements of the Administrative Procedure Act, this of course is a job for Congress rather than the courts. A bill which would accomplish this result by making the Tax Court a court in fact as well as in name is now pending before the Congress. H. R. 3214, 80th Cong. 1st sess. The fact that the legislators regard such a bill as necessary to remove the Tax Court from the operation of the Administrative Procedure Act (See Cong. Rec. July 7, 1947, pp. 8850 et seq) strengthens petitioner's contention that the Tax Court is presently subject to that Act, and that its failure to follow the Act's provisions requires reversal by this Court.

CONCLUSION

Wherefore it is submitted that the decision of the Tax Court should be reversed.

Respectfully submitted,

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No. 11829

**In the United States Circuit Court of Appeals
for the Ninth Circuit**

MITCHELL CAMERA CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

**ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES**

BRIEF FOR THE RESPONDENT

THERON LAMAR CAUDLE,
Assistant Attorney General.

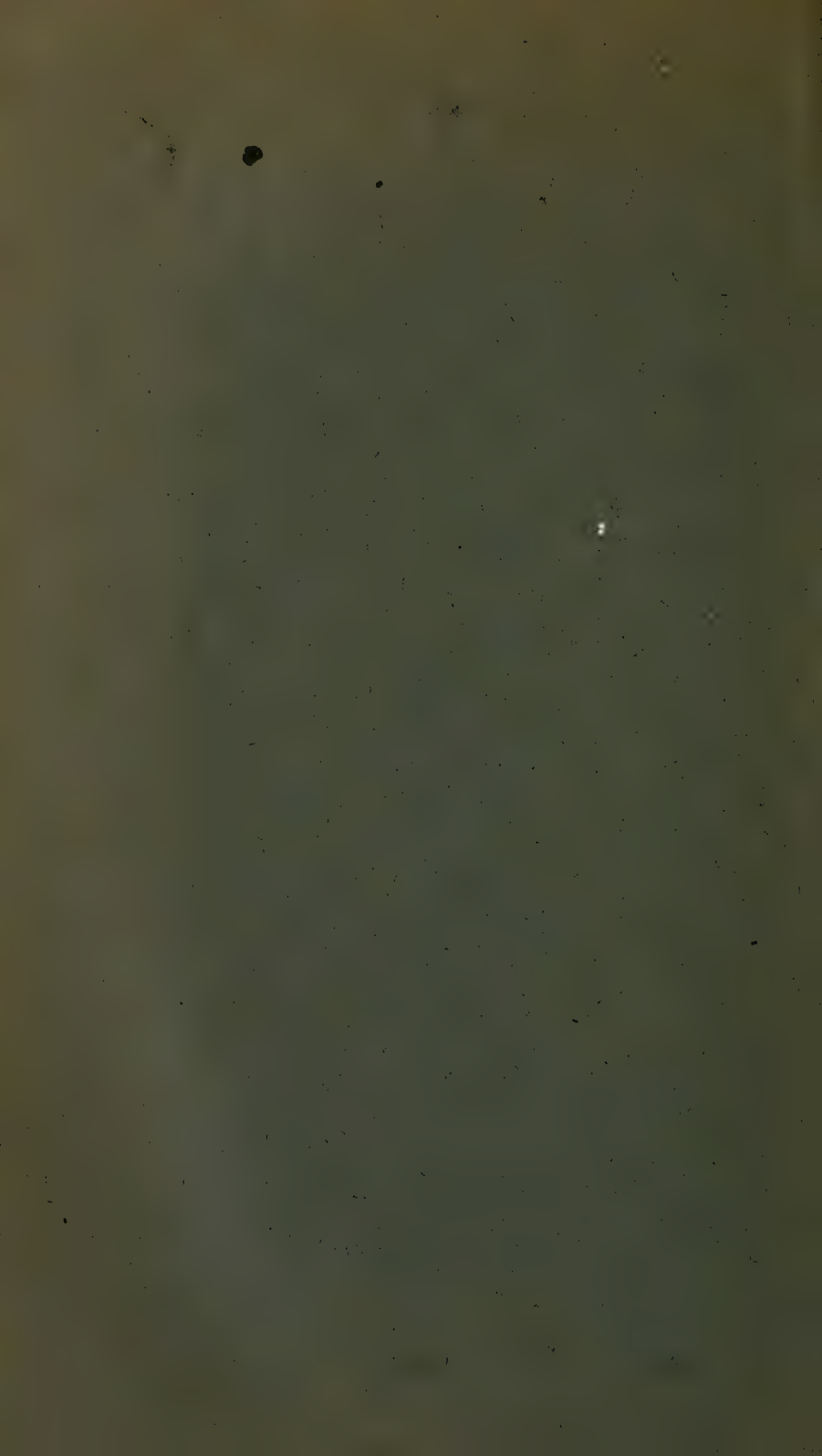
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MAY 23 1926

PAUL P. CROVET,

CLERK



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BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion is the memorandum findings and opinion by the Tax Court entered June 24, 1947 (R. 26-68), which is not reported.

JURISDICTION

The petition for review (R. 71-83) involves federal income taxes for the taxable year 1941. On February 27, 1945, the Commissioner of Internal Revenue mailed to the taxpayer notice of a deficiency in income tax in the amount of \$71,301.66. (R. 10-19.) Within ninety days thereafter, and on May 15, 1945, the taxpayer filed a petition with the Tax Court of the United States for redetermination of such deficiency under the provisions of Section 272 of the Internal Revenue

Code (R. 2), and thereafter, on November 4, 1946, it filed an amended petition (R. 3, 5-9). The decision of the Tax Court, redetermining the deficiency in the amount of \$47,720.78, was entered September 9, 1947. (R. 68.) The proceeding is brought to this Court by the petition for review aforesaid, which was filed November 3, 1947 (R. 4, 71-80), under the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED

1. Whether there is warrant in the record for the Tax Court's finding and holding that the taxpayer was not entitled to a deduction under Section 23 (1) of the Internal Revenue Code in the taxable year 1941 on account of depreciation of certain patents acquired by it in 1929.

2. Whether the Administrative Procedure Act has application here.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(1) *Depreciation*.—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business,
or * * *.

(n) *Basis for Depreciation and Depletion*.—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be al-

lowed in respect of any property shall be as provided in section 114.

(26 U. S. C. 1940 ed., Sec. 23.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property*.—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis*.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule*.—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this chapter or prior income tax laws. * * *

(26 U. S. C. 1940 ed., Sec. 113.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation*.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

(26 U. S. C. 1940 ed., Sec. 114.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.23 (1)-7. *Depreciation of patent or copyright.*—In computing a depreciation allowance in the case of a patent or copyright, the capital sum to be replaced is the cost or other basis of the patent or copyright. The allowance should be computed by an apportionment of the cost or other basis of the patent or copyright over the life of the patent or copyright since its grant, or since its acquisition by the taxpayer, or in the case of a copyright, since March 1, 1913, as the case may be. * * * The fact that depreciation has not been taken in prior years does not entitle the taxpayer to deduct in any taxable year a greater amount for depreciation than would otherwise be allowable.

STATEMENT

The facts as found by the Tax Court (R. 28-57), including those stipulated (R. 22-25), may be summarized as follows:

While this proceeding involves only a deficiency in the taxpayer's income taxes for the taxable year 1941, the determination of that amount requires the ascertainment of its correct net income for the taxable years 1939 and 1940, because of the carry-over net losses claimed by it for those years. (R. 26-27.)

Prior to May, 1929, one Harley L. Clarke was interested in acquiring the business and assets of the Mitchell Camera Corporation, a California corporation (hereinafter called "Mitchell of California"). Two-thirds of the stock of this corporation was owned

by one Henry F. Boeger and one-third by one George A. Mitchell. The corporation was in the business of manufacturing professional motion picture cameras and accessories for the large motion picture studios in California, all of its products being manufactured under patents which it owned. (R. 28-29.)

In 1929 one William Fox was generally engaged in the motion picture business and was the general manager of the taxpayer at the time of the hearing of this case, his family controlling its stock. (R. 29.)

In May, 1929, Clarke and Fox entered into an agreement or understanding for the formation of a corporation to be known as Grandeur, Incorporated (hereinafter called "Grandeur"), one-half of whose stock was to be subscribed for by each. It was also understood and agreed that another corporation was to be formed to take over the assets of Mitchell Camera of California which should either be independently operated by them or should be a wholly owned subsidiary of Grandeur, as should thereafter be mutually agreed upon between them or between their respective counsel. (R. 29-31.)

Thereafter, on June 6, 1929, Clarke entered into a contract with Boeger and Mitchell for the sale to him of all the assets of Mitchell of California for \$1,475,000, \$100,000 of which was forthwith to be deposited in escrow in a Chicago bank. (R. 31-32.) Boeger and Mitchell obligated themselves for a period of five years after the consummation of the purchase not to engage in the motion picture camera business other than with Clarke or a new corporation to be formed by him. They also agreed to enter the employ of the

new corporation in the same capacities as they had served Mitchell of California, at a stated salary of \$25,000 each per year beginning July 1, 1929. (R. 33-34.)

On June 13, 1929, Grandeur was incorporated under the laws of New York, one-half of its stock being acquired by Fox and one-half by Clarke for a stated consideration of \$4,000,000, under circumstances hereinafter described. (R. 34.)

On July 11, 1929, General Theatres Equipment, Inc. (hereinafter called "G. T. E."), was organized for the purpose of taking over certain properties owned by Clarke, who owned "just over control" of its stock. (R. 38.)

On July 12, 1929, the taxpayer was organized and, on the same day, Clarke made a proposal to the taxpayer to transfer to it all the properties, business and assets of Mitchell of California for a stated consideration of \$3,100,000 in cash. The proposal referred to a balance sheet, annexed thereto, which showed a net worth (capital stock and surplus) of \$330,480.50 for Mitchell of California as of December 31, 1928; and, in the proposal, Clarke represented to the taxpayer that, at the date of its acquisition of the assets of Mitchell of California, the taxpayer's financial condition would be at least as good as was reflected on the balance sheet annexed to the proposal. (R. 40.)

On July 16, 1939, Clarke, Boeger and Mitchell, acting as directors of the taxpayer, accepted Clarke's proposal, as well as a proposal of Grandeur (of which Clarke was the president), to acquire all of the taxpayer's capital stock for \$3,100,000. (R. 40-42.) And

Grandeur purchased the taxpayer's stock, but "as of July 1, 1929," for the stated sum of \$3,100,000. (R. 29.)

On July 27, 1929, Mitchell of California transferred its assets, other than patents, direct to the taxpayer, all constituting a party of the property included in the contract of June 6, 1929, above referred to, to be sold to Clarke by Boeger and Mitchell for a consideration of \$1,475,000; also on the same day there was transferred to the taxpayer by Mitchell of California and Boeger and Mitchell some thirty patents and patent rights on which patents were ultimately obtained. (R. 42-43.)

The final consideration of \$1,475,000 under the terms of the June 6, 1929, contract between Clarke and Boeger and Mitchell, was not paid to Boeger and Mitchell until the fall of 1929 (R. 44)—actually on August 24, 1929 (R. 48).

On August 1 and 2, 1929, a series of concurrent financial transactions occurred in effectuating the acquisition by Grandeur of the capital stock of the taxpayer and consummating the acquisition by the taxpayer, through Clarke, of the business and assets of Mitchell of California. (R. 44.) These may be summarized chronologically as follows:

On August 1, 1929, G. T. E. received \$11,400,000 from the sale of its securities. Of this \$2,000,000 was used to acquire fifty percent of the capital stock of Grandeur and \$3,000,000 to acquire four corporations, J. E. McCauley Manufacturing Company, Strong Electric Company, Ashcraft Automatic Arc Company

and Hall & Connolly, Inc. (hereinafter referred to as "the four lamp companies").¹ And, on the same date, Clarke deposited \$5,000,000 to his credit in the Chase National Bank of New York resulting in a balance in his account on that date of \$5,025,024.29. (R. 45.)

Also on the same day, Clarke issued two checks to Fox aggregating \$2,000,000 against this account. For the two checks received from Clarke, Fox by check paid into Grandeur on the same date \$1,950,000 towards one-half of its capital stock, having put up with Clarke prior thereto \$50,000 as down payment to apply to the purchase of the assets of Mitchell of California. In this connection, Fox testified that he had given the "Harley Clarke Interests" \$2,000,000 in checks in exchange for the \$2,000,000 in checks which he had received from Clarke. (R. 45-46.)

Clarke's bank account referred to showed a similar withdrawal of \$1,950,000 on August 2, 1929, in addition to the withdrawal of \$2,000,000 on the same date by way of the two checks to Fox. (R. 46.)

On August 1, 1929, Grandeur issued a check for \$3,000,000 payable to Mitchell Camera Corporation (the taxpayer), signed "Grandeur, Inc., by H. L. Clarke, President," which was honored by the bank on August 2, 1929, and shown by it as withdrawn from Clarke's account on that date and deposited on the same date to the account of Grandeur. (R. 46-47.)

¹ As regards the purchase of these four companies, the Tax Court found that out of G. T. E.'s \$11,400,000 fund \$3,000,000 was paid to Clarke to acquire the four lamp companies; but, to acquire these, Clarke paid only \$1,757,422.93. (R. 48.)

Also on August 2, 1929, Clarke's account showed a deposit of the taxpayer's check of \$3,000,000. This was shown as credited on the bank's statement immediately prior to Clarke's withdrawal of the \$2,000,000 and \$1,950,000 referred to. (R. 47.)

After the consummation of these check transactions on August 1 and 2, G. T. E. owned one-half of the stock of Grandeur at a cost of \$2,000,000,² and Fox owned the other half at no cost to him.³ Grandeur, in turn, owned and continued to own through the taxable year 1941 all the capital stock of the taxpayer, which it carried on its books at a value of \$3,100,000. The July 1, 1929, statement of assets and liabilities disclosed that of the total of \$3,900,000 represented by the two checks for \$1,950,000 each which Fox and Clarke had given it, Grandeur retained \$900,000 undisbursed cash, to be used as working capital. (R. 47.)

The amount of \$1,475,000 paid by Clarke to acquire the business and assets of Mitchell of California was obtained by him from G. T. E. out of its \$11,400,000

² This sum apparently represented the \$1,950,000 check which Clarke drew in the order of Grandeur, plus the \$50,000 which Clarke had deposited in escrow pursuant to his agreement with Boeger and Mitchell, of date June 6, 1929, for which he appears to have reimbursed himself out of the \$5,000,000 he had received from G. T. E.

³ While, of course, Fox got his half interest without cost to himself, it was paid for as will hereafter appear from the findings, by G. T. E.; for, as above stated, Clarke gave Fox two checks aggregating \$2,000,000 out of the \$5,000,000 he had received from G. T. E., for which Fox gave Grandeur his check for \$1,950,000, keeping the balance of \$50,000 to reimburse himself for the \$50,000 he had contributed to the escrow deposit under the agreement of June 6, 1929, between Clarke and Boeger and Mitchell. The Tax Court so found, as hereafter stated.

fund. Clarke had deposited \$100,000 on or before July 1, 1929, under the June 6, 1929, agreement of which Fox had advanced \$50,000. Fox was, however, later reimbursed for this \$50,000 advance by the check for \$2,000,000 dated August 1, 1929, received from Clarke, in exchange for his \$1,950,000 check to Grandeur. (R. 47-48.)

Clarke paid the balance due under the June 6, 1929, contract with Boeger and Mitchell of \$1,375,000, plus interest of \$14,627.58, or a total of \$1,389,627.58, on August 24, 1929. (R. 48.)

In addition to the two checks aggregating \$2,000,000, Clarke gave Fox 25,000 shares of G. T. E. stock at \$30 per share with a repurchase agreement valued at \$750,000. G. T. E. had approximately 2,000,000 shares outstanding. (R. 48.)

Grandeur and the taxpayer filed consolidated returns for the period July 1, to December 31, 1929. The statement of assets and liabilities of the taxpayer included net tangible assets valued at \$239,821.25, good will at \$2,805,157.59, patents at \$55,021.36, and capital stock outstanding of \$3,100,000. A deduction for depreciation on all assets of \$7,765.94 was claimed by the taxpayer in the return, and no adjustment of depreciation claimed was made by the Commissioner. (R. 49.)

The 1930 consolidated income tax return of Grandeur and the taxpayer reported net income of \$84,213.47. Patents were reported at a net value of \$52,961.28 at the beginning of the year, and at a value of \$92,768.11 less a reserve for depreciation of \$42,028.91, or a net value of \$50,739.20, at the end of the year,

and a value of \$2,805,157.59 was reported for good will, franchise rights and going concern value, both at the beginning and end of the year. The deduction for depreciation of patents claimed on the return was \$5,347.98, or approximately one-seventeenth of average basis of \$92,518.61. (R. 49-50.)

In 1931, the consolidated income tax return of Grandeur and taxpayer reported patents at a value of \$92,768.11 less a reserve for accumulated depreciation of \$42,028.91, or a net value of \$50,739.20 at the beginning of the year, and at a value of \$94,833.11 less a reserve for depreciation of \$47,514.16, or a net value of \$47,318.95 at the end of the year, and a value of \$2,805,157.59 was reported for good will, franchise rights, and going concern value at both the beginning and end of the year. The deduction for depreciation of patents claimed on the return was \$5,485.25, or approximately one-seventeenth of \$94,833.11. (R. 50.)

Prior to the closing of the returns for the taxable years 1930 and 1931, Grandeur and the taxpayer filed consolidated returns for 1932 reporting a net loss of \$102,819.84. In its statements of assets and liabilities attached to the return, the value of the taxpayer's good will was reported at \$1,555,157.59 as at the beginning and end of the year, and the value of its patents at \$1,344,833.11 as at the beginning and at \$1,345,909.91 as at the end of the year. These figures reflected a write-down of \$1,250,000 in the good will account and an identical write-up of that amount in the patent account, compared with 1931 closing balances. Accordingly, the opening 1932 balances showed good will at \$1,555,157.59 and patents at \$1,344,833.11;

the amount deducted for depreciation for that year being \$106,676.73, which was not changed by the Commissioner. (R. 52.)

However, in 1934, additional depreciation was allowed on account of the patents upon a revised basis. The patents were valued as of the date of the acquisition by the taxpayer in 1929 at \$1,180,157.59, being the difference between the cost price of the assets it purchased from Mitchell of California at that time of \$1,475,000 less the value of the net assets other than good will or \$294,842.41. Considering the life of the patents to be 12.3666 years, \$95,430.50 was allowed on account of patent amortization, resulting in an additional allowance on that date of \$90,082.52 for 1930 and \$89,945.25 for 1931. (R. 50-51.)

The taxpayer accepted these adjustments by a waiver agreement, which the Bureau in turn accepted by letter dated April 19, 1934. (R. 51-52.) Thereafter, in the taxable years 1933 to 1940, inclusive, patent depreciation was claimed by the taxpayer and allowed by the Commissioner on that basis. (R. 53-54.) Accordingly, there was allowed in 1940 \$49,187.34 on account of the remaining unexhausted portion of the cost value of the patents of \$1,180,157.59, as agreed to in 1934, with the result that no amount was allowed for such depreciation in 1941. (R. 55.) During these years—that is from 1933 to 1940, inclusive—good will was reported at \$1,555,157.59 (that being the amount at which it had been reported in 1932). (R. 53-54.)

In the year 1941, however, the taxpayer reported as at January, 1941, good will at nothing and patents at

\$105,895.54, but as at December 31, 1941, good will at \$1,680,021.36 and patents at \$1,198,892.12. (R. 54.)⁴

For the years 1939, 1940, and 1941, the taxpayer reported net losses in the following amounts, respectively, \$87,952.61, \$163,282.50 and \$7,121.24. (R. 54.)

Both Boeger and Mitchell were employed by the taxpayer for a period of years after 1929. Clarke was the controlling stockholder of G. T. E. and its president, as also the president of Grandeur. (R. 56.)

It was stipulated that the fair market value of the tangible property acquired by the taxpayer through Clarke from Mitchell of California was \$239,821.05; also that, in computing the deficiency the Commissioner determined the basis of the taxpayer's patents, applications for patent, and inventions, acquired by the taxpayer, as aforesaid, to be \$1,180,157.59. Accordingly he allowed depreciation of \$95,430.50 for the year 1939, \$49,187.34 for 1940 and nothing for 1941, arriving at the allowance for 1939 by spreading the basis over the average life of the patents, namely 12.3666 years (R. 23); it being further stipulated that the Commissioner's allocation of basis of patents was based on the price of \$1,475,000 paid by Clarke to the

⁴ It is to be noted that the figure of \$1,198,892.12 returned as the cost of patents as of December 31, 1941, represents the July 25, 1929, cost figure agreed to in 1934 of \$1,180,157.59, plus additions. (R. 14, 55.) Accordingly, the \$1,680,021.36 returned as the value of good will as of December 31, 1941, is arrived at by subtracting the \$1,180,157.59 figure from the cost of the patents, now claimed by the taxpayer (see its amended petition (R. 5)) of \$2,860,178.95. That figure, in turn, is arrived at by subtracting the stipulated value of the net taxable property of \$239,821.05 (R. 23) from the \$3,100,000 figure which the taxpayer claims to have paid Clarke for the assets of Mitchell of California.

stockholders of Mitchell of California for all of its properties, business and assets under the contract dated June 6, 1929 (R. 24).

In the taxable year 1941, the taxpayer claimed a deduction on account of patent depreciation of \$94,605.94 (R. 54), which the Commissioner reduced by \$93,578.16 (R. 13), the difference of \$1,027.78 representing allowances for depreciation on account of additions made in 1939, 1940 and 1941 (R. 55). The taxpayer's claim for a deduction to the extent of \$93,578.16 is based on its claim that the cost of the patents to it was \$2,860,178.95, representing the amount it claimed to have paid therefor in 1929 of \$3,100,000 less \$239,821.05, the fair value of the tangible assets then acquired by it. (R. 6-7, 57.)

The Tax Court sustained the Commissioner's determination insofar as it was based upon a disallowance of \$93,578.16, the amount of patent depreciation claimed by the taxpayer (R. 57-67), on the ground that the taxpayer had not proved that the actual cost of the assets and business of Mitchell of California was in excess of \$1,475,000. (R. 64.) The Tax Court further sustained the Commissioner's determination that the value of the net assets other than good will was \$294,842.41 and not \$239,821.05 which the taxpayer had asked to be substituted as the stipulated value of tangible assets. The reason given by the Tax Court is that the record amply demonstrated that intangible assets of substantial value exclusive of good will were received among the assets acquired from Mitchell of California, such, for example, as the agreements of the two organizers and operators of Mitchell

of California not to engage in this line of business for a period of years, as also a large backlog of contracts, which alone might have been worth the difference in the two figures. (R. 65-66.)

And, finally, the Tax Court concluded that, since the taxpayer acquired all of the patents of Mitchell of California, approximately thirty in number, no basis for allocation of the individual cost of each existed; hence, that the formula based on the average remaining life of the patents computed at 12.3666 years was properly used, and further that such formula had consistently been applied, the taxpayer having taken depreciation each year upon such basis, thereby exhausting the entire basis prior to the taxable year, so that it could not, after the exhaustion of its basis, recompute its allowances according to another formula. (R. 66-67.)

SUMMARY OF ARGUMENT

I

The problem here presented is one of accounting. Review of the Tax Court's decision is, therefore, governed by the principles of the *Dobson* case. A separate consideration of the component elements of the problem makes this clear. These are (1) the question as to what the taxpayer's patent cost was, such cost being its depreciation base; and (2) the question as to what formula should have been used in spreading the depreciation allowances over the lives of the thirty patents it had purchased. These questions are answered in their inverse order.

A. The formula used by the taxpayer in all of the taxable years from 1930 to 1940, inclusive, was the so-called "average life" formula, which spread the deductions over a period of 12.3666 years from the date the taxpayer purchased the patents in 1929. This period expired in 1941, the taxable year here in question; but, due to larger allowances for prior years than allowable under the formula, the taxpayer's patent cost had been entirely amortized by a final allowance made in 1940. The Tax Court has approved the use of this formula in this case. The formula has often been used by taxpayers with the approval of the Board of Tax Appeals and Tax Court, where the March 1, 1913 value of a group of patents was involved, or where, as here, a number of patents were purchased by the taxpayer and it was impossible to allocate a portion of the cost to the various patents in the group. It has, moreover, also been approved by several federal courts.

The taxpayer now claims for the first time that the "Simmons" formula is the only proper one to be used because of alleged conformity with the Regulations and should, therefore, have been used. The Simmons formula is so called because the Board of Tax Appeals approved its use in the case of *Simmons Co. v. Commissioner*, 8 B. T. A. 631. The Simmons formula does not, however, conform strictly to the provisions of the Regulations dealing specifically with the depreciation of patents, any more than does the average life formula. The reason is that the Regulations do not purport to deal with the amortization of a group of patents, but only of a single patent, in which case

the rule is that its March 1, 1913, value or cost, as the case may be, must be amortized over the life of the patent, or its remaining life, unless obsolescence is a factor. In the *Simmons* case, moreover, the Commissioner and the taxpayer had stipulated that reasonable depreciation allowances would result by its use there, and the Board of Tax Appeals had merely said that it saw no reason why it would not. By the use of this formula, the allowances were spread over the combined lives of the 131 patents involved in that case. The facts which satisfied the use of this formula there were, however, different from those here presented, and there is no reason to use it here. Furthermore, so far as we are aware, the Simmons formula has not been used since in any case which has reached either the Board of Tax Appeals, the Tax Court, or the federal courts.

B. As early as 1934, the Commissioner and the taxpayer had agreed that the taxpayer's patent cost was \$1,180,157.59, and that figure was used by the taxpayer as its patent depreciation base for the years 1930 to 1940, inclusive. This base was exhausted, however, as stated, in 1940. The evidence otherwise fully supports the Tax Court's finding that this amount (with an addition claimed by the taxpayer of \$55,021.36 which is now conceded) represents the taxpayer's patent cost. The taxpayer is not entitled to a further addition thereto of \$350,000 or \$400,000, which it claims was expended from its account by way of commissions in the acquisition of the patents. The Tax Court apparently discredited the testimony of the witness Clarke, who testified with regard to such alleged

expenditures, and for that reason refused to allow an increase in the taxpayer's patent cost on account thereof. The Tax Court committed no error in this respect.

II

The procedural provisions of the Administrative Procedure Act have no application to the Tax Court, or to the appellate court's review of its decisions. The dictum of the Sixth Circuit in its decision in the *Lincoln Electric Co.* case is erroneous. It has not been followed by that Court or by any other Circuit Court of Appeals and has specifically been disapproved by the Seventh Circuit in the *Anderson* case.

ARGUMENT

I

There is warrant in the record for the Tax Court's finding and holding that the taxpayer was not entitled to a deduction under Section 23 (1) of the Internal Revenue Code in the taxable year 1941 on account of depreciation of certain patents.

The problem presented

The problem here presented is one of accounting. Contrary to the taxpayer's various contentions, there are no questions of law, and certainly none of general importance, involved. There are, therefore, no errors in the Tax Court's decision which this Court could be called upon to correct, unless it be a mathematical error made by the Commissioner, and perpetuated by the Tax Court, in the computation of the taxpayer's patent cost, hereinafter referred to. The fact of the matter is that it would be difficult, indeed, to find a

case more clearly governed by the principles of *Dobson v. Commissioner*, 320 U. S. 489. A separate consideration of the various elements of the problem will clearly establish this.

Thus, in the first place, the question whether the taxpayer was entitled to a deduction in 1941 on account of patent depreciation depends primarily upon whether the cost of the thirty patents it had acquired from or through Harley L. Clarke in 1929 was \$2,860,178.95, as it contends (Br. 24-27), or \$1,180,157.59, as the Commissioner determined (R. 13-14, 54-55), and as the Tax Court found (R. 61-62, 64). The taxpayer's figure of \$2,860,178.95 represents the difference between \$3,100,000 which it claims to have paid for the assets of Mitchell of California, less \$239,821.05, the stipulated value of the "net tangible property" acquired by it. (R. 23.) On the other hand, the figure used by the Commissioner and approved by the Tax Court of \$1,180,157.59 represents the amount of \$1,475,000 which was actually paid by Clarke—and, as the Commissioner determined and the Tax Court found, by the taxpayer—to Mitchell of California for its assets, less the amount of \$294,842.41, which the Commissioner determined to be that portion of such amount representing the cost of the "net assets other than good will." (R. 51, 61.)

The Tax Court regarded the question whether the taxpayer's cost of the patent was \$2,860,178.95 or \$1,180,157.59 as being one of fact. We think that the Tax Court's appraisal of the nature of this issue is the correct one.

There are two other matters in connection with the cost figures which require explanation.

The first involves the Commissioner's error in the computation of the taxpayer's patent cost, already referred to. The error lies in the treatment given by the Commissioner to an item of \$55,021.36, which the taxpayer had initially set up on its books as the cost of the patents. (R. 48-49.) It will be noted that, in arriving at the \$2,860,178.95 patent cost figure, the taxpayer added the \$55,021.36 figure to the figure \$2,805,157.59, then set up on its books as representing the cost value of good will. (R. 51-52.) But, for the purpose of its return for 1941, the taxpayer transferred this amount to its patent account. Hence the \$2,805,157.59 figure is also the amount which taxpayer claimed as being the cost of the patents in its original petition,⁵ and it is the patent cost figure disclosed on the taxpayer's Exhibit 16, which was prepared by the taxpayer's accountant, Sydney R. Reed, and used by him in illustrating his testimony.⁶ (R. 108.) Of course, if the \$55,021.36 figure should be added to the \$2,805,157.59 figure in determining the taxpayer's cost of the patents at \$2,860,178.95, it should obviously

⁵ While the original petition is not included in the printed record, the taxpayer will not dispute this fact. In any event, the statement here made of a fact *de hors* the record is made only for the purpose of clarifying the issue, and not for the purpose of obtaining any argumentative advantage.

⁶ At this point it should be observed that the figure \$2,185,179.59, which the record shows as the one given by Reed (R. 108), is a typographical error. There is no such figure. Obviously it should be the figure \$2,805,157.59 given, as stated, on the taxpayer's Exhibit 16.

likewise be added to the \$1,180,157.59 figure, which the Commissioner and the Tax Court determined as the taxpayer's cost of the patents, thus increasing it to \$1,235,178.95. We think the taxpayer's contention as regards the true character of the \$55,021.36 figure is correct and should have been accepted by the Tax Court. It follows that the Tax Court erred in sustaining the Commissioner's contention that this figure represented good will, or rather that the taxpayer had not established otherwise. (R. 63.) Briefly, the situation with regard thereto appears to be as follows:

In determining Mitchell of California's tangible assets at \$294,842.41, the Commissioner accepted the Revenue Agent's report dated January 5, 1934. (R. 51.) But this report actually included the amount of \$55,021.36, at which the taxpayer, as stated, was then carrying the cost of its patents as of July 1, 1929; and, as appears from a statement of assets as of that date which is attached to its 1929 return (R. 49), the \$55,021.36 figure is the difference between the amount of \$294,842.41 and the amount of \$239,821.05, which is the stipulated value of the "net tangible property" acquired by the taxpayer "from or through H. L. Clarke" (R. 23).

The second matter bearing upon the cost of the patents is the taxpayer's contention (Br. 27-29) that Clarke paid between \$350,000 and \$400,000 as commissions in acquiring the assets of Mitchell of California. But the payment of commissions, if any, is relevant only if the patent cost as determined by the Commissioner, of \$1,180,157.59, is accepted; for in no

event could the \$2,860,178.95 cost figure, contended for by the taxpayer, be increased, for that is based upon the assumption that \$3,100,000 was paid by the taxpayer *to Clarke*—not *by Clarke* for the taxpayer—for the assets of Mitchell of California.

But whether Clarke actually paid such commissions, or any commissions, in connection with the acquisition by him of the assets of Mitchell of California was also regarded by the Tax Court as presenting a fact question, and we think its appraisal of the character of that question is likewise correct.

This leaves for consideration the taxpayer's contention that the Tax Court erred in using the so-called "average life" formula for determining the annual depreciation allowances, it being the taxpayer's claim that the "Simmons" formula, so called because its use was approved by the Board of Tax Appeals in the case of *Simmons Co. v. Commissioner*, 8 B. T. A. 631, affirmed on another point, 33 F. 2d 75 (C. C. A. 1st), certiorari denied, 280 U. S. 588, should have been used. The average life formula is a method of computing the amount of annual patent depreciation allowances over the composite average life of a group of patents. The average life is determined by dividing the aggregate of the unexpired life of the patents in the group by the number of patents therein. In order, then, to obtain the amount of the annual allowances, the value or cost of the group is divided by the average life. The aggregate unexpired life of the patents in this case, as stipulated in the taxpayer's Exhibit 8, was 361 years, 120 months; and this was divided by 30, the number of patents in the group, to arrive at the

average life figure of 12.3666 years, and it was this figure which was used by the taxpayer in computing its annual depreciation allowance for the years 1930 to 1940, inclusive. By the use of the "average life" formula, the taxpayer's cost, as determined by the Commissioner and approved by the Tax Court, was fully exhausted by allowances made in years prior to the taxable year 1941. On the other hand, the Simmons formula is based upon the total number of patent life months, in this case 4,452. Under it, the depreciation allowance in any given year during the 4,452 patent life months period is represented by a fraction of the cost of which the number of patent life months expiring in a given year is the numerator and the total number on the date of the acquisition of the unexpired patent life months in the period is the denominator. Thus, for example, since in the taxable year there expired 204 patent life months, the fraction for that year would be $204/4452$, which the taxpayer contends should be applied to whatever the patent cost is determined to be, that is, to either the cost claimed by the taxpayer to be \$2,860,178.95, or to the cost claimed by the Commissioner and found by the Tax Court to be \$1,180,157.59, as corrected.⁷

We believe that it will serve the purpose of clarity best if we discuss the matter of the formula first, and

⁷ But, for reasons hereafter pointed out, under the principles of *Virginian Hotel Co. v. Commissioner*, 319 U. S. 523, the Simmons formula can, in any event, be applied only to the unallowed balance of the taxpayer's cost as of December 31, 1938, if the cost figure as determined by the Commissioner and approved by the Tax Court, namely \$1,180,157.59, is used.

then the matter of the cost of the patents. Thus, we shall take up the two points involved in the issue in the case in the inverse order to that in which the taxpayer has discussed them, and shall finally briefly consider, under a separate heading (Point II), whether the Administrative Procedure Act has any application here.

A. The Tax Court committed no error in approving the amortization of the taxpayer's patent cost over the average life of the patents of 12.3666 years

In the case of a single patent, the rule is that deductions for depreciation are allowed over its life, i. e., seventeen years, unless obsolescence becomes a factor prior to the end of that period. *Hazeltine Corp. v. Commissioner*, 32 B. T. A. 4, 19. See to similar effect Section 19.23(1)-7 of Treasury Regulations 103, promulgated under the Code and applicable to the taxable year 1941, here in question.

But the Board of Tax Appeals early recognized that a literal adherence to this rule would deprive the taxpayers of all patent depreciation deductions where the March 1, 1913, value of a group of patents expiring at different dates was involved, or where such group was purchased by the taxpayer. For, in such a case, each patent could not be separately valued, and this difficulty would render valuation generally impossible. Accordingly, in the first case which came before it for the allowance of depreciation deductions of a group of patents based upon their March 1, 1913, value, the Board of Tax Appeals denied the Commissioner's contention that no depreciation deductions should be allowed because of the impossibility of evaluating each patent, and held that deductions were

permissible under the statute over the average life of the patents. This rule has been called the average life formula, and has been continuously applied ever since. From a perusal of the cases in which the rule has been invoked, it appears that the interdependence of the patents is a primary consideration and that in the hands of separate owners they would have little value; also that, in the case of group patents, some of the patents often represent improvements on others and the value of the group consists largely in the combination of the various patents therein. *Union Metal Manufacturing Co. v. Commissioner*, 4 B. T. A. 287, 290, being the case in which the principle was first definitely stated, cf., however, *Union Metal Manufacturing Co. v. Commissioner*, 1 B. T. A. 395, 400; *Deltox Grass Rug Co. v. Commissioner*, 7 B. T. A. 811, 815-816; *R. Hoe & Co. v. Commissioner*, 7 B. T. A. 1277, 1289; *Weser Bros., Inc. v. Commissioner*, 12 B. T. A. 1394, 1399; *Western Wheeled Scraper Co. v. Commissioner*, 14 B. T. A. 496, 502; *National Water Main Cleaning Co. v. Commissioner*, 16 B. T. A. 223, 241; *Syracuse Food Products Co. v. Commissioner*, 21 B. T. A. 865, 890; *Standard Conveyor Co. v. Commissioner*, 25 B. T. A. 281, 283; *Prophylactic Brush Co. v. Commissioner*, 25 B. T. A. 676, 686; *Hazeltine Corp. v. Commissioner*, *supra* (32 B. T. A. p. 19). So far as we know, the Tax Court's application of this formula has never before been questioned in an appellate court.

A second rule has been developed, no doubt as an outgrowth of the average life formula, in cases where

there was a principal patent or patents to which all others were referable. In such cases, the allowances have been spread over the life of the principal patent or patents rather than over the average life of all of them. *Individual Towel & Cabinet Service Co. v. Commissioner*, 5 B. T. A. 158, 162-163; *Hartford-Fairmont Co. v. Commissioner*, 12 B. T. A. 98, 103; *Hyatt Roller Bearing Co. v. United States*, 43 F. 2d 1008, 1019 (C. Cls.); *Hazeltine Corp. v. Commissioner*, 32 B. T. A. 110, 120-121, affirmed on this point 89 F. 2d 513, 521 (C. C. A. 3d); *Heberlein Patent Corp. v. United States* (S. D. N. Y.), decided March 9, 1938 (23 A. F. T. R. 1132, 1137), affirmed on another point, 105 F. 2d 965 (C. C. A. 2d); *Addressograph-Multi-graph Corp. v. Commissioner*, decided February 5, 1945 (1945 P-H T. C. Memorandum Decisions, par. 45,058).

On the other hand, the Simmons formula for which taxpayer contends, permits the spreading of the depreciation deductions over a period represented by the combined lives of all of the patents, allocating to each year in such period a fraction of the cost of the group, as already explained. While referring (p. 642) to the *Union Metal Manufacturing Co.* case, *supra* (4 B. T. A. 305), on the question of group valuation, the Board of Tax Appeals said in the *Simmons* case (p. 644) that it saw no reason why the method agreed upon by the parties as the proper method of calculating the deduction should not be used in that case, the only contested issue being as to patent value.

However, in establishing the value of the group of the 131 patents in question in the *Simmons* case, the evidence was exhaustive as to the relative value of various groups of patents within the group. Thus the evidence disclosed that the useful life of certain of the patents continued after their expiration because of later improvement, and, furthermore, that the last patent issued was the most important of all, since it revived, so to speak, the entire patent structure.⁸ Thus what appears to have been a singular situation was presented in the *Simmons* case, a situation which not only was without precedent, but is without parallel since. Accordingly, it has never, so far as we are aware, been applied in any other case; and, certainly, the facts in the case at bar do not present the slightest resemblance to those in that case.

The taxpayer's Exhibit 8 is a list of the thirty patents owned by Mitchell of California which the taxpayer purchased on September 27, 1929. The exhibit shows that three of these expired as early as 1936 and the others in subsequent years, the last expiring in 1950. Thus the three first had only seven years to run, the last six the full seventeen years, and the rest from eight to sixteen years. The combined lives of the patents in the taxpayer's hands was twenty-one years.

The taxpayer does not claim that the statute, Sec-

⁸ On the other hand, where the last patent was the principal one, and all prior patents and patent applications became merged therein, the amortization period of the group was held to have been the life of the last one. *Individual Towel & Cabinet Service Co. v. Commissioner, supra* (5 B. T. A., p. 162-163); *Prophylactic Brush Co. v. Commissioner, supra* (25 B. T. A., p. 686).

tion 23 (1) of the Internal Revenue Code, *supra*, specifically requires that the allowance be spread over the combined lives of all of the patents. Indeed, as the Tax Court pointed out in its opinion, the statute provides no formula by which to compute amortization of patent cost, particularly where, as here, a group of patents was purchased. (R. 67.) The taxpayer's sole claim (Br. 30-35) is that the applicable Regulations, already referred to, so require. But, as stated, these Regulations purport to deal only with a case involving depreciation allowances in respect of a single patent and have uniformly been held inapplicable where, as here, a number of patents expiring at different dates, and having different lengths of life in the taxpayer's hands, are purchased in a group.

However, the taxpayer contends (Br. 31) that, because under the Simmons formula allowances are made in each year in which one or more of the patents is alive, it is the only formula which satisfies the requirements of the Regulations that allowance be made over the life of each patent. Such contention is, we submit, without merit. For the Simmons formula allocates over the combined patent life period of the group a portion of the value of each patent and thus allocates a portion of the value of each over that portion of the amortization period remaining after its expiration. Indeed, it may also serve to allocate a portion of later patents over a period prior to their issue. In this respect, this formula works on principle no differently from the average life formula. The difference is that the Simmons formula serves to lengthen the amortizable life of the patents, whereas the average life for-

mula serves to shorten it. Thus the question as to whether one or the other should be used resolves itself into a question of the exercise of judgment on the part of the Tax Court in the light of the facts of the particular case. We, therefore, turn to an examination of the facts in this case in order to demonstrate that the Tax Court committed no error in approving the use of the average life formula here.

The following table based on the taxpayer's Exhibit 8 shows the number of patent applications acquired by the taxpayer on July 27, 1929, as well as patents issued in each year from 1919 to 1933, inclusive, when the last one was issued, and the year in which each expired; also the approximate number of years each was owned by the taxpayer before its expiration and the number which expired in each year.

Number of patents and year of issue	Year of expiration	Approximate number of years each patent was owned by taxpayer before its expiration	Number of expired patents at end of each year
3 issued in 1919.....	1936	7	3 at end of 1936.
4 issued in 1920.....	1937	8	7 at end of 1937.
4 issued in 1921.....	1938	9	11 at end of 1938.
2 issued in 1922.....	1939	10	13 at end of 1939.
0 issued in 1923.....	1940	-----	13 at end of 1940.
0 issued in 1924.....	1941	-----	13 at end of 1941.
1 issued in 1925.....	1942	13	14 at end of 1942.
5 issued in 1926.....	1943	14	19 at end of 1943.
2 issued in 1927.....	1944	15	21 at end of 1944.
2 issued in 1928.....	1945	16	23 at end of 1945.
2 issued in 1929.....	1946	16	25 at end of 1946.
0 issued in 1930.....	1947	-----	25 at end of 1947.
3 issued in 1931.....	1948	17	28 at end of 1948.
1 issued in 1932.....	1949	17	29 at end of 1949.
1 issued in 1933.....	1950	17	30 at end of 1950.

It will thus be seen that at the end of 1939 the lives of thirteen patents had expired and there remained

only seventeen. The situation was the same at the end of both 1940 and 1941, for no patents had been issued which expired in those years.

No evidence was adduced as to the relative importance of the patents, or as to the extent of the dependence of any one of them upon the other. Nor was any attempt made to allocate the cost among the patents, or to divide them into smaller groups for the purpose of valuing them, and there was no evidence that one or more of the earlier patents were not the basic or principal ones; or, contrarywise, that one or more of the later ones were the basic or principal patents, or that, whichever were the basic or principal ones, the improvements made by the others thereon served effectively to continue their monopolistic value during the entire period.

The very determination of the Commissioner as early as 1934 that the average life formula was the proper one to be used here, to say nothing of the taxpayer's acceptance of such determination and its use of the formula during such period, leads fairly to an inference, in the absence of any evidence whatever to the contrary, that one or more of the earlier patents were the basic patent or patents and that the others merely constituted improvements or additions thereto, which to a large extent depended for their value upon the continued existence of the earlier patent or patents.⁹

⁹ The average life of the patents was 12.3666 years, as stated, and the cost as determined by the Commissioner \$1,180,157.59. The yearly allowance was therefore \$95,430.50, which was arrived at by dividing the cost by 12.3666. Of course, the period began

Indeed, it was only after the cost of the patents as determined by the Commissioner and accepted by the taxpayer had been completely amortized that the taxpayer for the first time asserted that another formula (the Simmons formula) should have been used extending the amortization period to and including the year the last patent will expire, namely, 1950, as stated.

The reason, of course, is that by recomputing the yearly depreciation allowances in accordance with the Simmons formula for the taxable years 1939, 1940 and 1941 (the years here open to possible recomputation), the taxpayer will gain a tax advantage not only in the taxable year 1941, but in subsequent taxable years, as well. However, by the application of the Simmons formula to the \$1,180,157.59 cost figure approved by the Tax Court in its opinion (or even to the corrected figure of \$1,235,178.95), the taxpayer would lose the tax advantages it now has in 1939 and 1940, and gain little in 1941. This is so because it received larger allowances in 1939 and 1940 by using the average life formula than it would receive in those years by the use of the Simmons formula, with the result that the depreciation allowance in 1941 under the Simmons formula would be more than

on July 27, 1929, the date the patents were purchased by the taxpayer, and it ended in the latter part of 1941. Hence an allowance of \$95,430.50 would normally have been made in 1940, and one of a slightly smaller amount in 1941. However, due to allowance in excess of \$95,430.50 in prior years, the entire cost had been amortized prior to 1941, and all of it except \$49,187.34 prior to 1940. Hence, the allowance for 1940 made by the Commissioner in his deficiency determination was in that amount, none being allowed in 1941. (R. 14, 55.)

offset by the resultant reduction of the amount of the net loss carry-over from 1939 and 1940 to 1941. It is to be noted that such net loss carry-over resulted only from the fact that the allowance on account of patent depreciation in 1939 was \$95,430.50, and in 1940 \$49,187.34. But, as indicated, the allowances for 1939 and 1940 will be materially reduced if the Simmons formula is used. For the case of *Virginian Hotel Co. v. Helvering*, 319 U. S. 523, prevents the application of the Simmons formula, or any other formula than that used, to any year prior to 1939, since, as stated, no years prior thereto are open for consideration here, or otherwise. Therefore, if the Simmons formula is now used, the aggregate amount of the deductions allowed prior to 1939 cannot be disturbed although these are in excess of the aggregate amount allowable, and although the taxpayer may not have derived any tax advantage therefrom.

Thus, at the end of 1938, there remained only \$144,617.84 undepreciated cost, being the difference between \$1,180,157.59 cost figure approved by the Tax Court and the \$1,035,539.75 which, allowed to December 31, 1938 (R. 14, 55), \$95,430.50 in 1939, and \$49,187.34 in 1940. It would, therefore, at best, be only this difference (adjusted by the addition of \$55,021.36) which could be amortized subsequent to 1938 by the application of the Simmons formula. And, to amortize that amount over the years 1939 to 1950, would reduce annual allowances in those years to about \$12,000 (or to about \$16,000 if the adjusted figure is used), wiping out the net losses for 1939 and 1940 and hence the net loss carry-over from those years to 1941.

It follows that the taxpayer would gain a tax advantage in 1941 only to the extent of a deduction of \$12,000 (\$16,000) on account of patent depreciation. It would, therefore, be necessary, in order for the taxpayer to obtain any great advantage from the use of the Simmons formula, that its patent cost be increased, as it contends it should be, from the \$1,180,157.59 figure to the \$2,860,178.95 figure, which it now claims.

In the event the latter figure is used, the adoption of the Simmons formula may require a recomputation of the annual allowances over all of the years from 1929 to 1950, inclusive. For the *Virginian Hotel Co.* case may not serve to prevent it, since the allowable deductions would then be greater in each year than those which were actually allowed, the reverse of the situation in *Virginian Hotel Co.* case.

Of course, all this is academic if, as we believe we have shown, there is no evidence whatever which would justify the use of the Simmons formula, to say nothing of the fact that, even if there were some evidence to justify its use, whether it should nevertheless have been used would still have been a matter resting solely within the judgment of the Tax Court. Cf. *Commissioner v. Rainier Brewing Co.*, 165 F. 2d 217 (C. C. A. 9th), rehearing denied February 18, 1948 (1948 C. C. H., par. 9184) and the companion case of *Seattle Brewing & Malting Co. v. Commissioner*, 165 F. 2d 216 (C. C. A. 9th) rehearing denied February 18, 1948 (1948 C. C. H., par. 9188). Moreover, since the Tax Court here (similarly as in the *Simmons Co.* case) merely approved the formula used by the Commissioner and the taxpayer in computing annual patent

depreciation allowances (R. 66-67), it is obvious that its decision can have little value as a precedent (see *Commissioner v. Scottish American Co.*, 323 U. S. 119), for it lays down no rule of general applicability which is reviewable (see *Trust of Bingham v. Commissioner*, 325 U. S. 365).

We, therefore, submit that, however the matter may be approached, the Tax Court's approval of the use by the Commissioner and the taxpayer of the average life formula in computing the taxpayer's patent cost depreciation allowances presents nothing for review.

B. Except for conceded adjustment, the evidence sustains the Tax Court's finding that the taxpayer's patent cost was \$1,180,157.59

The taxpayer's contention is (Br. 14-18) that it paid \$3,100,000 for all of the assets of Mitchell of California, and that the contrary conclusion of the Tax Court has no support whatever in the record. Accordingly, it further contends (Br. 18-24) that it paid \$2,860,178.95 for the patents, being the difference between the \$3,100,000 paid by it for all of the assets of Mitchell of California and the stipulated value of its tangible assets of \$239,821.05. We think the record lends no support to this conclusion; but, if it does, then that there is ample evidence from which the Tax Court could have reached a conclusion that the taxpayer's cost of all the assets of Mitchell of California was \$1,475,000, of which the cost of the patents was \$1,180,157.95, subject to the adjustment which we have conceded. However, for the sake of simplicity, we use the uncorrected figure here, since that was used throughout the trial of the case, as well as in the Tax

Court's findings and opinion and in the taxpayer's brief. The facts supporting the Tax Court's finding that the taxpayer's patent cost was \$1,180,157.59 are as follows:

Originally, as stated, the taxpayer set up on its books a patent cost figure of \$55,021.36 and good will at \$2,805,157.59, making a total of the \$2,860,178.95, the patent cost figure now claimed by the taxpayer. Accordingly, in its income tax returns for the taxable years 1929, 1930 and 1931, the taxpayer stated the cost of its patents in amounts based on the \$55,021.59 figure and made claims for patent depreciation allowances on that basis. (R. 49-50.) In 1932, however, it reported the net value of its patents to be \$1,344,833.11 at the beginning of the year and \$1,345,909.91 at the end. These figures reflected a write down of good will of \$1,250,000 and a corresponding write-up of patent values. (R. 52.)

Thereafter, in 1934, the Commissioner adjusted the patent value, or cost, figure to \$1,180,157.59, representing the amount of \$1,475,000, which Clarke had paid—as the Commissioner contends for the taxpayer—to Mitchell of California for all of its assets, less \$294,842.41, which he then determined as representing the value (purchase price) of its tangible assets. (R. 51.) We have already conceded that this should have been the stipulated figure of \$239,821.05 (R. 23), the difference being the \$55,021.36 figure above referred to. However, the \$1,180,157.59 figure determined by the Commissioner as the taxpayer's patent cost was accepted by it (R. 51-52), and it was

upon the basis of that figure that its 1930 and 1931 allowances for patent depreciation were recomputed, no change being made by the Commissioner, however, in the allowance the taxpayer had claimed for 1932. Accordingly, in its returns for 1933 to 1940, inclusive, the taxpayer claimed and was allowed depreciation upon an original patent cost of \$1,180,157.59, plus whatever additions had been made thereto during these years. (R. 14, 55.)

Here then we have a continuous formula^{al} declaration on the part of the taxpayer covering a period of eleven years from 1930 to 1940, inclusive, specifically reiterated in its returns for 1933 to 1940, inclusive, that its cost of the Mitchell of California assets was \$1,475,000, and its cost of the latter's patents \$1,180,157.59.

The reason for now asserting that these figures do not after all correctly represent the cost of such assets and of the patents should also be taken into consideration. It is, as stated, that an acceptance of the larger patent cost figure will give the taxpayer important tax advantages not only in 1941, but in subsequent years to and including 1950, as well, which it would not otherwise be able to obtain. What then is the basis of the taxpayer's assertion that the heretofore agreed to and used patent cost figure is not the correct one, but that the one it now contends for is?

Clarke was apparently the brains behind the organization of a corporation known as the General Theatres Equipment, Inc. (G. T. E.), organized to finance the purchase not only of the assets of Mitchell of California but of those of a number of other concerns manufacturing equipment used by the moving picture

industry in the production of moving pictures. In this venture, he interested William Fox, but apparently only on condition that the latter would receive a substantial interest therein without actually costing him anything.

Pursuant to an agreement reached between Clarke and Fox, in furtherance of the scheme, for the acquisition of the assets of Mitchell of California, each deposited \$50,000 in escrow to be paid to the owners of that company, Boeger and Mitchell. G. T. E. was then organized by Clarke who received "just over control" of its stock (R. 38), and some \$11,000,000 of its securities were sold to the public, of which \$5,000,000 was placed at Clarke's disposition, \$2,000,000 of which was earmarked for the purchase (directly or indirectly, as the case might be) of the assets of Mitchell of California and \$3,000,000 for the purchase of the assets of four lamp companies. Clarke also organized a corporation called Grandeur, one-half of whose stock was to be acquired by himself, for himself and Fox, and the other half by G. T. E. And, finally, Clarke organized the taxpayer all of whose stock was to be owned by Grandeur.

Out of the \$5,000,000 Clark made the following disbursements. He first gave a check to Fox for \$2,000,000. Out of this Fox reimbursed himself for the \$50,000 original payment made by him in escrow for the benefit of the owners of Mitchell of California. The balance of \$1,950,000 Fox paid to Grandeur. Clarke then matched this payment by also giving a check for \$1,950,000 to Grandeur. Thus Grandeur received altogether \$3,900,000, all paid out of the

\$5,000,000 fund which Clarke had received from G. T. E. But, of the \$3,900,000 received by Grandeur, it permanently retained only \$900,000. The balance of \$3,000,000 was paid by it to the taxpayer for the latter's stock, and the taxpayer immediately returned this amount to Clarke in ostensible payment for the assets of Mitchell of California which Clarke, however, did not purchase until later for \$1,475,000, also paid out of the \$5,000,000. Of the \$1,475,000, \$1,375,000 was represented by a check given by Clarke to Boeger and Mitchell directly, to which should be added the \$50,000 paid by Clarke to Fox for the purpose of reimbursing him for the latter's original payment in escrow for the benefit of Boeger and Mitchell, as well as the \$50,000 paid by Clarke to Boeger and Mitchell for which he was also reimbursed. (R. 59.)¹⁰

It is thus apparent that \$3,000,000 of the amount paid by Clarke either directly or to or through Fox was immediately returned to him after passing through Grandeur and the taxpayer. Obviously, the sole purpose of passing this amount through Grandeur

¹⁰ In the Tax Court's opinion, the check drawn by the taxpayer to Clarke for the assets of Mitchell of California is stated to have been \$3,100,000 (R. 59) which is also the amount given in Clarke's offer to sell these assets to the taxpayer, which the latter accepted. But no such amount appears in Clarke's bank account. (Commissioner's Exhibit W; R. 133-134.) There the figure is \$3,000,000. (R. 46-47.) See also the taxpayer's Exhibit 15, which is Grandeur's check to the taxpayer for \$3,000,000. (R. 105.) It is nowhere explained how the taxpayer got the other \$100,000. The taxpayer's bank account shows the deposit of Grandeur's check for \$3,000,000 and on the same day a withdrawal of that amount represented by a check to Clarke, leaving no balance. (R. 46-47.)

and the taxpayer was to permit the making of book-keeping entries showing payments of that amount to both Grandeur and the taxpayer and thus *pro forma* to justify, on the one hand, the purchase by Grandeur from the taxpayer of \$3,000,000 par value of the latter's stock for \$3,000,000, and, on the other hand, the purchase by the taxpayer from Clarke of the assets of Mitchell of California for that amount.

Actually, of course, no more than \$1,450,000 was paid by anyone for the assets of Mitchell of California, for at no time was \$3,000,000 in actual cash available for that purpose; and, in final analysis, the \$1,475,000 was paid by Clarke for the taxpayer.

As regards Clarke's functions in this matter, the taxpayer argues (Br. 16) that Clarke personally made a profit out of this transaction and that there is no justification for excluding such profit from the taxpayer's cost merely because his promotional activities may have put him in better position to make the sale, and therefore to realize the profit for himself than anyone else. Accordingly, the taxpayer asserts (Br. 17) that Clarke's transactions with, and interest in, other corporations are not relevant to and do not alter the fact that he sold the assets in question—that is, for his own account—to the taxpayer for \$3,100,000 (sic). It concludes (Br. 17) that the fact that he personally sold the property to the taxpayer, i. e., for that amount conclusively determines the taxpayer's cost and, therefore, its basis for patent amortization.

But what the taxpayer has overlooked is that Clarke testified he made no profit out of any of the transac-

tions of G. T. E., and by this statement he unquestionably meant to include his purchase from Boeger and Mitchell of the assets of Mitchell of California, as well as their sale to the taxpayer. (R. 124.) For he had already testified that the intention was that during the period he owned the Mitchell Camera Company of California (meaning its assets), and before it was turned over to the taxpayer, he owned it as agent for G. T. E. (R. 120.) We turn then to the question whether \$3,000,000, or more than \$1,475,000, was ever actually available for the purchase of the assets of Mitchell of California.

As we have said, all payments for the acquisition not only of the assets of Mitchell of California, but for the purchase of the four lamp companies, as well, were made out of the \$5,000,000 fund which G. T. E. had placed at Clarke's disposal for that purpose. Indeed, Clarke himself so testified (R. 125), although he had theretofore stated that the payment he had made to Fox of \$2,000,000 came out of his personal funds (R. 123). But this was obviously not true, if thereby he meant to say that he did not pay the amount out of the \$5,000,000 he had received from G. T. E. In any case, the Tax Court on a review of all of the evidence specifically found that the payment made by Clarke to Fox of \$2,000,000 came out of that fund (R. 45-46), and there can be no question, we submit, that this finding is in strict accordance with the facts.

Of course, Clarke also testified that the payment of \$1,475,000 paid to Boeger and Mitchell for the assets

of Mitchell of California and the payment for the four lamp companies, stated by him to have been \$1,699,000 (cf. R. 122, where he said that the exact amount was \$1,699,422.93), were made out of the fund, except that he stated the amount of the fund to have been \$6,100,000 instead of \$5,000,000. (R. 125.) There can, of course, be no question that the fund was \$5,000,000 (R. 117), and so the Tax Court found (R. 45), although here again Clarke confused this fact by his statement, on the one hand, to the effect that he had paid from \$350,000 to \$400,000 as commissions in the acquisition of the assets of Mitchell of California and, on the other, that he had also paid "perhaps a couple of hundred thousand" in commissions in the acquisition of the four lamp companies, and by further immediately thereafter stating that G. T. E. had acquired the four lamp companies and its interest in Grandeur for around \$5,322,000 (R. 118). But the fact of the matter is that Clarke paid exactly \$1,757,422.93 for the four lamp companies, and so the Tax Court found. Indeed, the Tax Court was able from the evidence to and did break down this figure into the payments made to each of the four companies. (R. 48.)

The following table, set up in three columns, shows how both the purchase of the assets of Mitchell of California and that of the four lamp companies was financed, and how \$3,000,000 of the total payment of \$3,900,000 made out of the fund to Grandeur by Clarke directly and through Fox, and by Grandeur to the taxpayer, was washed out by the taxpayer's return of it

to Clarke and the latter's redeposit of the amount in his personal bank account in which the \$5,000,000 fund had been deposited. The first column in the table shows the manner in which Clarke used the \$5,000,000 fund to finance the purchase by Fox of a one-half interest in Grandeur and by G. T. E. of the other half, as well as Grandeur's acquisition of all of the stock of the taxpayer, and the latter's acquisition through Clarke of the assets of Mitchell of California, as also the acquisition by G. T. E. of the four lamp companies. The second column shows the actual permanent distribution of moneys out of the fund, aggregating \$4,132,422.93, and the last column the actual unexpended balance of \$867,577.07. The last column shows the \$5,000,000 received by Clarke from G. T. E., as well as the return to Clarke of \$3,000,000 thereof through the taxpayer. The washing out of this amount is shown in stricken-through type in both the first and last columns.

The financing of Grandeur; the acquisition of half of its stock for Fox and the balance for G. T. E.; the acquisition of the assets of Mitchell of Cal. for the taxpayer, and of the four lamp companies for G. T. E.	Actual outlays made by Clarke	Deposits in and total actual withdrawals from Clarke's bank account
<i>August 1</i>		
Received by Clarke from G. T. E. for acquisition of assets of Mitchell of Cal.----- \$2, 000, 000 And of the 4 lamp companies _ 3, 000, 000		\$5, 000, 000
Clarke gave Fox \$2,000,000 out of which Fox reimbursed himself for payment made to Boeger and Mitchell 6/6/29_ 50, 000	\$50, 000	
Balance of \$2,000,000 received by Fox from Clarke paid to Grandeur for one-half of its stock----- 1, 950, 000		
Clarke also paid to Grandeur on behalf of G. T. E. for remaining half of its stock---- 1, 950, 000		
Total paid Grandeur--- 3, 900, 000 Of which Grandeur retained--- 900, 000	900, 000	
Balance paid by Grandeur to the taxpayer for all of its stock and by the latter to Clarke, who redeposited it on Aug. 2----- \$3, 000, 000		3, 000, 000
Clarke also received back the \$50,000 initial payment he had made to Boeger and Mitchell----- 50, 000	50, 000	
<i>August 24</i>		
Bal. paid by Clarke to Boeger and Mitchell for assets of Mitchell of Cal.----- 1, 375, 000	1, 375, 000	
<i>Date not given</i>		
Paid by Clarke to acquire 4 lamp companies for G. T. E. 1, 757, 422. 93	1, 757, 422. 93	
Total actual outlays made by Clarke---	4, 132, 422. 93	4, 132, 422. 93
Unexpended balance-----		867, 577. 07

It is thus apparent that the passage from Clarke to Grandeur (one-half through Fox); from Grandeur to the taxpayer, and from the latter back to Clarke, was a device to accomplish three things: (1) the repayment to Fox of the \$50,000 he had paid to Boeger and Mitchell; (2) the giving to Fox of a one-half interest in Grandeur, free of cost to him, and (3) the payment to Grandeur of \$900,000 for its treasury; the remaining half interest in Grandeur being taken by Clarke for G. T. E., of which Clarke owned one-half, as stated.

Actually, therefore, the only consideration the taxpayer paid for the assets of Mitchell of California was its capital stock, which the taxpayer issued to Grandeur in pursuance of the agreement made between Clarke and Fox on May 24-25, 1929, that such assets should be purchased by Clarke pursuant to negotiations he was then conducting with Boeger and Mitchell. (R. 29-31.) And such negotiations culminated, as stated, in Clarke's purchase of these assets for \$1,475,000, pursuant to his June 6, 1929, agreement with Boeger and Mitchell. (R. 31-34.) Moreover, for what it is here worth, these assets were transferred by Mitchell of California directly to the taxpayer, and on July 27, 1929, that is, six days prior to the financial transactions between Clarke, Fox, Grandeur and the taxpayer, and nearly a month before Clarke made the final payment on August 24, 1929, to Boeger and Mitchell of the \$1,375,000 with interest. (R. 43.) If more than this were needed to show the unreality of the purported \$3,000,000 payment by the taxpayer to Clarke for these assets, it may further be

pointed out that such payment appears to have been made before Clarke had even given his \$2,000,000 check to Fox, and before he and Fox had each given his check for \$1,950,000 to Grandeur. For an examination of Clarke's bank account disclosed that the \$3,000,000 check he had received from the taxpayer was deposited by him before he withdrew the \$2,000,000 he paid to Fox and the \$1,950,000 he paid to Grandeur. Without doubt, therefore, the Tax Court correctly evaluated the situation when it said in its opinion that the only arm's-length transaction in this shuffle of checks was that between Clarke and Boeger and Mitchell. (R. 63.) Thus, if in this case the taxpayer's claim that the amount of \$3,000,000 must be accepted as representing the cost of Mitchell of California's assets, then any other amount which Clarke and Fox might have decided upon would have had to be accepted, provided only that its payment had taken the ring-around-the-rosy course which the \$3,000,000 payment here in question did.

The case of *Commissioner v. Matheson*, 82 F. 2d 380 (C. C. A. 5th), which the taxpayer cites (Br. 17) and apparently relies on heavily to support its contention that the \$3,000,000 payment by the taxpayer to Clarke must be accepted as representing its cost of the Mitchell of California assets, is obviously not in point. For taxpayer in that case actually relinquished a legacy of a value of \$130,700 for certain stock even though the stock did not have a market value of that amount. As we have shown, the taxpayer here never actually had \$3,000,000 and besides

the assets of Mitchell of California were bought by Clarke for taxpayer, not for himself, for \$1,475,000.

This leaves for consideration on this phase of the case the question whether the taxpayer's cost of the assets of Mitchell of California should also be increased by \$350,000 or \$400,000, which Clarke said he had paid as commissions in acquiring them. The taxpayer argues (Br. 27-29) that the evidence conclusively establishes that Clarke paid out either the one or the other amount in commissions, and that at least the smaller amount, or perhaps some other still smaller amount should have been added to its cost, citing *Cohan v. Commissioner*, 39 F. 2d 540 (C. C. A. 2d), and *Isbell Porter Co. v. Commissioner*, 40 F. 2d 432 (C. C. A. 2d).

However, the fact that Clarke paid out any amount in commissions in connection with the acquisition of these assets is not conceded; nor is the fact that some amount was actually given established, as it was in the cited cases. The Tax Court disposed of the taxpayer's contention that Clarke did make such payments by reviewing Clarke's testimony on this point in its opinion, and by its comment thereon that it thought more evidence than that was required upon which to base a finding of additional cost by reason of commissions paid. In reviewing the evidence on this point, the Tax Court pointed out that there was no evidence to show to whom the commissions had been paid; that they were vaguely described as aggregating between \$350,000 and \$400,000, and that, at the hearing before a Senate Committee, the evidence was

that, in all, \$100,000 had been paid in connection not only with the acquisition of the assets of Mitchell of California, but of other corporations by G. T. E., but that there was no showing that even any part of that amount had been paid in connection with the transactions here in question. (R. 64-65.)

The taxpayer asserts (Br. 28) that the Tax Court did not intimate that it discredited Clarke's testimony, even if it had been at liberty to do so. But we submit that it not only did discredit such testimony but that it was at liberty to do so. There is, moreover, no merit to the taxpayer's contention that the burden of proof was upon the Commissioner to elaborate Clarke's testimony, since it was given while he was testifying as a Government witness. But this was an issue posed by the taxpayer in its amended petition. (R. 7.) Furthermore, Clarke was actually the taxpayer's principal witness, and was called by the Government only to develop certain facts, which had not been developed by the taxpayer. He volunteered the information that he had paid these commissions while testifying as the Commissioner's witness, and the matter was not pursued by the taxpayer. In any event, his testimony on this point cannot be reconciled with his other testimony. For he also testified that he paid \$200,000 in commissions for the acquisition of the four lamp companies. If so, he paid altogether between \$550,000 and \$600,000 in commissions. As we have already shown, Clarke actually paid out \$4,132,422.93 in the acquisition of the assets of Mitchell of California and the four lamp companies. If the

\$550,000 or \$600,000 is added to that, the total amount paid would be either \$4,682,422.93 or \$4,732,422.93, depending on which figure is added. But Clarke testified immediately after having testified as to the payment of these commissions that G. T. E. had acquired the four lamp companies and the interest in Grandeur for "five million three hundred and twenty-two thousand odd dollars." (R. 18.) Not only that, but thereafter he testified, as we have already said, that he had paid \$1,699,000 for the lamp companies, \$1,475,000 plus \$350,000 or \$400,000 for Mitchell, making a total of \$3,524,000 or \$3,574,000 as the case may be. (R. 125.) If we add the \$200,000 he said he paid as commissions in connection with the purchase of the four lamp companies, we now have a total of \$3,724,000 or \$3,774,000, as the case may be, which obviously bears no relation whatever to the \$5,322,000 figure he had first given. (R. 118.)

Is it possible that, in these circumstances, the Tax Court was compelled to believe this witness when he said that he had paid between \$350,000 and \$400,000 as commissions in connection with the acquisition of the assets of Mitchell of California? Would a jury have been required to find that he had paid either sum, or any sum? The obvious answer is in the negative. It is well settled that the Tax Court need not accept as absolutely true the self-serving statements of interested witnesses, even though they are not impeached by direct contrary evidence. Indirect evidence may in itself be, and in this case certainly is, sufficiently contradictory thereof to warrant the Tax

Court in rejecting it. See *Quock-Ting v. United States*, 140 U. S. 417, 420; *Helvering v. Nat. Grocery Co.*, 304 U. S. 282, 285; *Helvering v. Stock Yards Co.*, 318 U. S. 693, 701; *Cohen v. Commissioner*, 148 F. 2d 336 (C. C. A. 2d); *Andrew Jergens Co. v. Conner*, 125 F. 2d 686, 689 (C. C. A. 6th); *Birnbaum v. Commissioner*, 117 F. 2d 395 (C. C. A. 7th); *Rand v. Helvering*, 77 F. 2d 450 (C. C. A. 8th); *United States v. Washington Dehydrated Food Co.*, 89 F. 2d 606 (C. C. A. 8th).

The only remaining question is whether, when the Tax Court said that it thought more evidence than that which Clarke had given on the subject was required upon which to base a finding of additional cost by reason of commissions paid, it was not in effect saying that it did not believe Clarke's testimony in this respect. This is a wholly fallacious assumption, for as the Supreme Court in *Stone v. United States*, 164 U. S. 380, 382, pointed out, to say, as the Tax Court did in effect, that the evidence of Clarke did not satisfactorily explain the transaction is more polite and less offensive than to say that it did not believe the witness, and at the same time equally suffices.

We, therefore, submit that there is ample evidence to sustain the Tax Court's finding that the taxpayer's patent cost was the amount \$1,180,157.59, plus, of course, the amount of \$55,021.36, as we have conceded.

II

The Administrative Procedure Act has no application here

The taxpayer contends that both the Tax Court's procedure and the review of its decisions by this Court

are governed by the so-called Administrative Procedure Act, c. 234, 60 Stat. 237. Its primary reliance in support of such contention is the Sixth Circuit's moribund dictum in *Lincoln Electric Co. v. Commissioner*, 162 F. 2d 379.

A short answer, however, so far at least as this case is concerned, is that, in virtue of Section 12, the Act has no application to any proceeding instituted prior to its effective date, as is the case here. For, so far as concerns us here, Section 12 provides that the Act shall take effect three months after its approval. The Act was approved June 11, 1946. Accordingly, its effective date is September 11, 1946, and this proceeding was initiated by the taxpayer in the Tax Court on May 15, 1945.

Even so, the Sixth Circuit's dictum is erroneous and has not been followed either in that Circuit or in any other. Indeed, the Seventh Circuit has expressly rejected it as unsound in *Anderson v. Commissioner*, 164 F. 2d 870. The court there pointed out that such dictum had obviously not even been accepted by all of the judges of the Sixth Circuit.

Moreover, in *MacDonald v. Commissioner*, 165 F. 2d 213, the Sixth Circuit has itself implicitly rejected a contention that the procedural provisions of Section 8 of the Act are applicable to the Tax Court. For in that case it affirmed the Tax Court by a *per curiam* decision rendered within two days after the argument, although similarly as here, the Tax Court had rejected the taxpayer's contention that it must comply there-

with and the Sixth Circuit was appealed to to reverse the Tax Court's decision on that point.

However, a letter written by the Attorney General to the Chairman of both the House and Senate Judiciary Committees states the Government's position in this matter. It is that the procedural provisions of the Administrative Procedure Act do not apply to the Tax Court nor affect the requirement of resort thereto. See S. Doc. 248, 79th Cong., 2d Sess., entitled Administrative Procedure Act, Legislative History, pp. 224, 408. This is so, although the Tax Court is not technically a court, but an independent administrative tribunal exercising quasi-judicial functions in reviewing deficiency determinations of certain taxes made by the Commissioner of Internal Revenue. See *Commissioner v. Gooch Co.*, 320 U. S. 418, and authorities there cited. The legislative history of the Act amply bears out the Attorney General's view of the matter. (S. Doc. 248, pp. 202, 214, 260, 279, 332, 334, 359, and 370.)

In any event, Congress did not intend in anywise to modify existing statutory methods of review (S. Doc. 248, p. 15), and the so-called "substantial evidence" rule was in nowise intended to be changed thereby (S. Doc. 248, pp. 30, 39, 208, 230, 270, 279, 349, 370, 410 and 415).

CONCLUSION

For the reasons stated, the case should be remanded to the Tax Court but only to recompute the taxpayer's patent depreciation allowance, if any, for the year

1941, upon the basis of a patent cost computed by adding \$55,021.36 to the cost determined by the Tax Court in the sum of \$1,180,157.59. In all other respects, however, the Tax Court's decision should be affirmed.

Respectfully submitted.

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APRIL 1948.

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No. 11,829

PETITION FOR REHEARING

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

MITCHELL CAMERA CORPORATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

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Date: September 14, 1948.

FILED

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No. 11,829

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

MITCHELL CAMERA CORPORATION,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE
Respondent.

PETITION FOR REHEARING

The petitioner, Mitchell Camera Corporation, respectfully petitions the Court for a rehearing.

GROUND FOR THIS PETITION

The grounds of this petition are:

I. The decision is based upon the principles of *Dobson v. Commissioner*, which were repudiated by Congress.

II. The decision does not decide the issue of the applicability of the Administrative Procedure Act to this case.

ARGUMENT

The decision is based upon the principles of *Dobson v. Commissioner*, 320 U. S. 489 which were repudiated by Congress by Public Law No. 773, enacted on June 16, 1948 and approved by the President on June 25, 1948. It is true that

this amendment to the Judicial Code did not become effective until September 1, 1948, but its enactment was a recognition by Congress that the principles of the *Dobson* case were contrary to the original Congressional intent as to reviews by the Circuit Courts of Appeal of the decisions of the Tax Court of the United States.

It seem unfair and unjust that the petitioner should be prejudiced by a decision made after Congress had repudiated the principles upon which the Court based its decision and only eight days remained before the legal demise of the already repudiated principles. Such unfairness to this petitioner should have been avoided by a slight delay in the decision of the Court, or by a refusal to defeat justice by the application of principles of law already rejected by Congress.

Moreover, Public Law No. 773, repudiating the *Dobson* principle, has become effective prior to this Court's issuance of its mandate or remand of the case to the Tax Court. This court therefore retains "exclusive jurisdiction to review the [decision] of the Tax Court * * * in the same manner and to the same extent as decisions of the District Court in civil actions tried without a jury" as provided for in that statute, and has a duty to do so. Accordingly, no mandate based on the *Dobson* principle should now be issued, but instead a rehearing should be granted and the decision of the Tax Court reviewed in accordance with Public Law No. 773.

The arguments that the procedure in the Tax Court and the review of the case by this Court are governed by the Administrative Procedure Act are not referred to in the Court's opinion. As these questions are pending before the Court in the *Kennedy Name Plate Co. v. Commissioner of Internal Revenue*, decision should have been deferred in this case pending the decision of the Court in the *Kennedy Name Plate* case, or the issue should have been decided in

this case. It is clear that the Administrative Procedure Act is applicable to the Tax Court for the reasons stated in petitioner's brief pp. 38 to 46, and the Circuit Court of Appeals for the Sixth Circuit so held in *Lincoln Electric Co. v. Commissioner*, 162 F (2d) 379 and *Dawson v. Commissioner*, 163 F (2d) 664.

A rehearing is respectfully requested.

Respectfully submitted.

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